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Good Faith in Landlord – Tenant Relations

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When the *Civil Code of Québec* ("CCQ") came in effect in 1994, some may have noted the importance parliament placed on the notion of good faith. Two out of the nine first articles of the CCQ refer to it; in the introduction to the chapter on obligations, parliament once again highlighted the importance of this principle.[1] In this bulletin, we will be taking a closer look at several recent judgments involving tenant-landlord relations that deal with the obligation of good faith.

Good Faith and the Corporate Veil

In *Assurance-vie Desjardins Laurentienne Inc. and S.I.R.R. Desjardins Inc.* v. *3458286 Canada Inc. and Cohoes Fashions Inc.*,[2] an unsatisfied tenant asked the landlord to reduce its rent and, after fruitless negotiations, ceased paying it altogether. This forced the landlord to take action to collect the rent owing and ask that the lease be terminated. The landlord also sought partial reimbursement of an amount it gave the tenant for "fixturing", namely a percentage of this sum corresponding to the unused term of the lease vis-à-vis the whole term ("the Unamortized Portion of the Allowance"), and this in light of the fact that the lease contained a provision allowing both the landlord and the tenant to terminate the lease under certain conditions by paying the other party the Unamortized Portion of the Allowance, which then rose to approximately $171,000. The tenant's obligation was guaranteed by Cohoes Fashions Inc. ("Cohoes"), its parent company.

In the court's opinion, the tenant stopped paying rent simply to avoid paying the $171,000 and to force the landlord to terminate the lease; it was an obvious ruse and smacked of bad faith. A review of the Cohoes corporate structure only confirmed the finding – the tenant was an empty shell, all revenues being transferred to the parent company. Moreover, even though the tenant had ceased paying rent for several months, it still had no assets, and all cash receipts for that period had disappeared.

The tenant, according to the court, was acting in bad faith, and was merely the *alter ego* of Cohoes, a façade used to protect its parent company's assets. The Superior Court lifted the corporation veil and solidarily sentenced the tenant and Cohoes to pay the rent owing and the Unamortized Portion of the Allowance.

Good Faith and the Obligation to Mitigate or Minimize Damages

In *Groupe Cliffton Inc.* v. *Solutions Réseau d'Affaires Meta-4 Inc.*,[3] a tenant installed automatic teller machines in five of the landlord's properties. The operation was a resounding failure. The tenant met with the landlord and explained that, without help, it would have to cease operations. True enough, the tenant closed down shortly thereafter.

The landlord brought the tenant to court to force it to honour its lease. The landlord was seeking specific performance of the agreement, and did not believe it had the obligation to mitigate its damages. In fact, it made no attempt whatsoever to rent the spaces abandoned by the tenant. The Court of Appeal confirmed that the rule providing for the obligation to mitigate damages[4] only applies to reparation for an injury. But, according to the court, the good faith conduct required by the CCQ[5] applies to all private law; this means that, under the circumstances, the landlord is under the obligation to make efforts to lease the abandoned spaces. Having done nothing in that respect, the landlord was in breach of its good faith obligation. The court insinuated that the decision might have turned out differently had the tenant also been guilty of bad faith and left without first seeking the landlord's cooperation.

Good Faith and Game Rule Changes

Several points of law were debated in *Aéroports de Montréal* v. *Hôtel de l'Aéroport de Mirabel Inc. et al.*,[6] both at trial and on appeal, including the issue of good faith on the part of the airport manager (the "Manager").

The Manager made two important decisions that had an impact on the future of the Mirabel airport business. First, in 1996, it announced a "liberalization" policy and offered carriers, barring few exceptions such as chartered flights, the opportunity to operate either from Montréal or from Mirabel. This decision had only a minor effect on operations of the hotel adjacent to the Mirabel airport, as the hotel essentially drew its clientele from chartered flight passengers. With respect to this first decision, the Court of Appeal concluded that the hotel was entitled to receive damages but not to terminate its lease, the prejudice suffered not being sufficiently serious. Then, in 2002, the Manager announced that it would soon be rerouting all passenger flights to Dorval, a decision that would deprive the hotel of 80% of its goodwill. According to the Court of Appeal, the impact of this decision on the hotel operator would be such that it could no longer meet its costs, and the hotel was therefore justified in terminating its lease.

Note that the court could have reached the same conclusions by invoking the notion of change of form or destination of the premises.

Good Faith and Respect of Third Parties

In *91133 Canada Inc. (Bankruptcy of)* v. *Groupe Thibault Van Houtte et Associés Ltée*,[7] the Court of Appeal was called upon to settle a banner war between two groups of pharmacies.

One pharmacist, in league with its landlord and the pharmacy chain he wanted to join, came up with the following strategy: the pharmacist would go bankrupt, his landlord would then exercise its right to terminate the lease due to bankruptcy, then sign an offer to lease the premises to the new chain that would hire the bankrupt pharmacist. After analyzing the transaction, the court concluded that the strategy benefited its three authors to the detriment of all of the creditors. The landlord wanted the court to confirm the lease's cancellation and validate the new lease with the new banner. But the court refused on the grounds that exercising the lease termination clause following bankruptcy was unlawful due to the strategy's injurious effect on the creditors. The court added that though such a clause is not under all circumstances abusive or illegal, it certainly was in the case in point, and there could be no doubt of the bad faith of the tenant and his partners, or of the adverse effect on the creditors.

The court applied similar reasoning to the clause allowing the tenant to terminate the lease instead of agreeing to or refusing a lease assignment. Although such clauses are valid, they become abusive when they are exercised to adversely affect a third party.

Conclusion

Actions that are entirely legal under the law or the contract could be deemed an abuse of right giving rise to remedy where there is evidence of bad faith. No party can hide behind a contract. If a person claims to be abiding by the terms of an agreement but is really acting in bad faith, the court will look beyond the terms of the agreement.

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1. "The parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished.";
2. J.E. 2003-1859, C.S.M., July 31, 2003; under appeal ;
3. J.E. 2003-1954, C.A.M., October 7, 2003;
4. Article 1479 CCQ;
5. *Inter alia*, articles 6, 7 and 1375 CCQ;
6. [2003] R.J.Q. 2479, CAM, August 12, 2003;
7. [2003] R.J.Q. 753, CAM, February 11, 2003.