LAPOINTE ROSENSTEIN MARCHAND MELANÇON
L.L.P. Attorneys

Newsletter

Commercial Law

July 2020

Recent Developments in Québec Commercial Leasing and Equipment Leasing Matters

M^tre^ Antonietta Melchiorre

M^tre^ Marvin Liebman

M^tre^ Nicholas Backman

On July 16, 2020, the Superior Court of Québec rendered a decision that may have important implications for commercial lessors and lessees of real estate and of equipment in the province. In *Hengyun International Investment Commerce Inc.* v. *9368-7614 Québec Inc.*, the Court, *inter alia*, excused the defendant ("**Lessee**") from paying rent from March 24, 2020 through June 2020, being the period of time during which the Lessee was unable to operate its premises as a result of the Government Decree in response to the COVID-19 pandemic (the "**Decree**").

Force Majeure (Superior Force)

Since 2018, Lessee operated a gym at premises leased from the plaintiff ("**Lessor**"). While the Court's analysis in the case at hand covered a range of issues, the most important part of the decision for lessors and lessees is arguably how the Court deals with the application of the *force majeure* concept in light of the COVID-19 pandemic.

Lessee essentially argued that its inability to operate the premises during the Government-ordered shutdown was caused by *force majeure*. Accordingly, Lessee contended that it should be excused from its obligation to pay rent.

Lessor, on the other hand, argued that these circumstances did not constitute *force majeure* and that, in the alternative, Lessee was required to pay rent notwithstanding the situation, as a result of the application of Section 13.03 of the parties' lease, which read as follows:

> **13.03 Unavoidable Delay**
>
> […] if the Landlord or the Tenant is delayed or hindered in or prevented from the performance of any term, obligation or act required hereunder by reason of superior force [i.e., *force majeure*], […] restrictive governmental rules, regulations or orders, […] or any other event […] which is beyond the reasonable control of the Landlord or Tenant […], then the performance of such term or obligation or act is excused for the period of the delay, and the party so delayed shall be entitled to perform such term, obligation or act within the appropriate time period after the expiration of such delay, without being liable in damages to the other. **However, the provisions of this Section 13.03 shall not operate to excuse the Tenant from the prompt payment of [Rent] or any other payments required under the lease.** (Emphasis added)

Finally, Lessor maintained that Lessee should have applied the funds which it received from an emergency government loan offered in the context of the COVID-19 pandemic to pay rent. Accordingly, Lessor argued that Lessee was not precluded from actually paying rent because of *force majeure*.

The Court reviewed the principle of *force majeure*, which constitutes an unforeseeable and irresistible event, as defined at Article 1470 of the *Civil Code of Québec* (the "**CCQ**"). The Court, in this case, held that an event is unforeseeable if it could not have reasonably been foreseen at the time the lease was entered into. The Court concluded that the circumstances of the COVID-19 pandemic met this requirement. The Court also held that an irresistible event means that it must be impossible for any person to perform the obligation in the circumstances.

Interestingly, the Court seemingly turned on its head the argument of Lessor, i.e., that *force majeure* did not release Lessee from its obligations to pay rent, concluding, in fact, that Lessor was prevented from fulfilling its obligation under the lease and under law to provide Lessee with peaceable enjoyment of the leased premises as a result of a *force majeure*. In doing so, the Court referred to the "Use" clause in the lease, which required Lessee to use the premises solely as a gym, and determined that since this activity was prohibited under the Decree, Lessee had no peaceable enjoyment of the premises during the period during which the Decree was in force.

Moreover, since it was impossible for Lessor to perform its obligation to provide peaceable enjoyment of the premises to Lessee, which the Court excused in the circumstances, the Court held that Lessor could not insist that Lessee pay rent during that period.

The Court acknowledged that the obligation to provide peaceable enjoyment is not of public order, and that parties may limit the impact of such obligation in their lease. However, it commented that the parties to a lease cannot altogether exclude a lessor's failure to provide peaceable enjoyment of leased premises, as this obligation is at the very essence of the contract of lease. The Court did nonetheless acknowledge that the parties chose to limit such obligation at Section 13.03 of their lease.

The Court rejected Lessor's argument that the "Unavoidable Delay" clause at Section 13.03 of the parties' lease required Lessee to pay rent notwithstanding the occurrence of a *force majeure* event preventing the gym from operating. The Court found that the "Unavoidable Delay" clause was drafted in such a way that it applied exclusively to situations of *force majeure* where the performance of obligations was delayed; not to obligations that could not be performed at all. Consequently, the Court granted an abatement of rent in favour of Lessee for the period during which it did not have peaceable enjoyment of the leased premises as a result of the Decree.

Impact in Commercial Real Estate Context

This decision is a potentially critical blow for lessors, many of whom may have taken the position that their lessees were obligated to pay rent notwithstanding the effects of the COVID-19 pandemic, in particular due to wording in their leases similar to the "Unavoidable Delay" clause described herein. It will be interesting to see how future decisions interpret the obligation to provide peaceable enjoyment of leased premises when lessees are unable to operate their businesses at leased premises in accordance with their "Use" clauses as a result of the COVID-19 pandemic or an associated governmental decree. At the time of the drafting of this article, none of the parties had appealed the decision.

Impact in Equipment Financing Context

We think that this case should also be of interest to equipment lessors and finance companies engaging in sale leaseback transactions in the Province of Québec. A sale leaseback transaction does not qualify for *crédit-bail* (contract of leasing, which under local law is different than a contract of lease) treatment, one of the notable elements of which is that rent is payable come hell or high-water or, in more legal terms, that the equipment lessee assumes all risks of loss of the property, even by *force majeure* (Article 1846 CCQ). As such, sale leaseback transactions are likely characterized under local law as contracts of lease, and accordingly are subject to the same provisions of law as apply to leases of premises. We have long advised clients entering into sale leaseback transactions in respect of equipment in the Province of Québec of the local law doctrine, as also articulated by the Court of Appeal, to the effect that the very essence of a lease (as opposed to a *crédit-bail* (contract of leasing)) is that the lessee has peaceable enjoyment of the leased property, and that a Court may interpret and apply the hell or high-water provisions of an equipment lease arising from a sale leaseback transaction through that lens, particularly where an equipment lessee in a sale leaseback transaction is completely deprived of peaceable enjoyment of the leased property. With this decision, and subject to any appeal thereof, we are of the view that such lens is now far thicker than before, and will blur hell or high-water wording in a contract governing a lease of equipment arising from a sale leaseback transaction.

If you have questions with respect to your commercial lease or equipment lease, please contact one of our specialized attorneys, who will be pleased to advise you.

For more information, contact one of the team members:

Antonietta Melchiorre
514 925-6355
antonietta.melchiorre@lrmm.com

Marvin Liebman
514 925-6367
marvin.liebman@lrmm.com

Nicholas Backman
514 925-6417
nicholas.backman@lrmm.com