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A Welcome Primer on Interpreting Covenants in Leases

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Cases Considered:

Orbus Pharma Inc. v. Kung Man Lee Properties Inc., 2008 ABQB 754.

This case is about the proper interpretation of a term in a commercial lease concerning the ability of the tenant to assign or sublet the premises. The provision appeared to say that when the tenant asked for the landlord's consent to an assignment or sublease, the landlord could either consent or refuse consent or - and this was the controversial point - cancel the lease altogether. Although this clearly reasoned and well-written decision turns on the exact wording of the relevant provision in the lease, there is nevertheless a great deal of precedential value in this decision because of the principles of law used by Justice Scott Brooker in his approach to the interpretative task. Characterizing the provision as "astute bargaining" on the part of the landlord that allowed it to terminate a lease with a rent substantially below market rates (at para. 68), this judgment is also a marked contrast with the decision in *550 Capital Corp. v. David S. Cheetham Architect Ltd.*, 2008 ABQB 370. In that earlier case, the tenant's contorted efforts to evade the consequences of a similar clause in its lease were rewarded: see the critique of this decision written by Nick Rafferty and myself in "What's Wrong with Landlord's Rights?"

The facts that gave rise to the controversy in *Orbus Pharma Inc. v. Kung Man Lee Properties Inc.* occurred more than a decade ago. The plaintiff, the Bovar Environmental Partnership, had rented downtown Calgary office space from the defendant landlord, Kung Man Lee Properties Inc. The lease was for a five year term from November 1, 1995 to October 31, 2000.

In 1997, Bovar decided to sell most of its assets to Conor Pacific Environmental Consulting Inc. That sale required Bovar to get Kung Man Lee Properties' consent to the assignment of the lease to Conor. When Bovor made its request for the landlord's consent, however, the landlord advised Bovar that, in accordance with Section 17.03(iii) of the Lease, the landlord elected to cancel the lease rather than give its consent. No reason other than Clause 17.03 was given for cancellation.

Bovar went ahead with the sale of its assets to Conor Pacific. However, it had to reduce the purchase price of its assets by $167,053.50 in order to do so. That amount represented the difference between the rent under the lease and the rent Conor Pacific would have to pay for the space at market rates.

Bovar sued the landlord for the $167,053.50. Bovar refused to accept the landlord's cancellation of the lease, arguing that Clause 17.03 could only be triggered by a "reasonable withholding" of consent. Because there was no basis for a "reasonable withholding" of consent by the landlord, Bovar argued that the landlord had breached the lease.

The issue to be determined was whether the lease permitted the landlord to terminate the lease rather than consenting to its assignment when there was no reasonable basis for withholding consent. The answer was yes, the lease did permit the landlord to do exactly that. The plaintiff's action was dismissed.

As I indicated earlier, the decision turns on the exact wording in the relevant provisions of the particular lease and the court's interpretation of those provisions. Nevertheless, Justice Brooker's review of the principles of contract interpretation that informed his analysis and decision are of general interest, as are the Supreme Court of Canada and Alberta Court of Appeal decisions cited as authority for those principles.

Justice Brooker begins (at para. 25) with the goal of the interpretive exercise. The aim of all rules and principles of contract interpretation is to help the court find "an interpretation that reflects and promotes the intention of the parties at the time they entered into the contract." *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 is authority for this proposition.

Justice Brooker then states (at para. 26) the first, primary, or "cardinal" rule of contract interpretation, which is that "the court should give effect to the intentions of parties as expressed in their written document" (para. 26, quoting from *Manulife Bank of Canada v. Conlin*, [1996] 3 S.C.R. 415 at para. 79). How does the court do this? The intent of the parties is determined by the words they used in the contract, according to *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 at para. 54. The court focuses on the written contract and the words used by the parties in that contract. It does not consider evidence extrinsic to the words used by the parties to the written contract if that document is clear and unambiguous on its face: *Eli Lilly* at para. 55. This prohibition on extrinsic evidence is called the "parol evidence rule."

Justice Brooker then sets out (at para. 27) several other rules of contract interpretation that support the cardinal rule. First, a court must, if possible, give effect to all of the provisions in a contract: *BG Checo International Ltd. v. British Columbia Hydro & Power Authority*, [1993] 1 S.C.R. 12 at para. 9. Second, a court cannot "simply pick and choose clauses - or parts of clauses - without considering the contract as a whole:" *ATCO Electric Ltd. v. Alberta (Energy and Utilities Board)*, 2004 ABCA 215 at para. 77. Third, in order to give effect to all provisions in the contract, it may be necessary to "strive to harmonize apparently conflicting terms in a contract:" *369413 Alberta Ltd. v. Pocklington*, 2000 ABCA 307 at para. 19. Fourth, in striving to harmonize apparently conflicting terms, the court's interpretation will often read specific terms as qualifying more general terms, that is to say that "the terms may be reconciled by taking the parties to have intended the scope of the general term to not extend to the subject matter of the specific term:" *BG Checo* at para. 9.

Although a court is not to consider evidence extrinsic to the words used by the parties if the written contract is clear and unambiguous on its face, as Justice Brooker notes (at paras. 27 and 28) a court may consider the absence of words in the contract (*Geoffrey L. Moore v. Manitoba Motor League (c.o.b.) CAA Manitoba* (2003), 10 R.P.R. (4th) 1 (Man C.A.) at para. 12) and the surrounding circumstances or the relevant background against which the contract was concluded: *ATCO* at para. 77.

In the lease at issue in this case, some of the words in relevant provisions were crossed out. Are those words extrinsic evidence and thus to be excluded from consideration? Justice Brooker notes (at paras. 31 to 34) that there is substantial authority establishing that crossed out (or struck) words should not be considered in interpreting a contract. For example, in *Indian Moylbdenum Ltd. v. The King*, [1951] 3 D.L.R. 497 (S.C.C.) at 503, it was held that "words deleted by the drawing of a line through them, and this deletion initialed by the parties, cannot be looked at."

One exception to the parol evidence rule arises in the event of ambiguity in the language of the contract. In such instances, extrinsic evidence is admitted to clarify the meaning of the ambiguous words or phrases: *United Brotherhood of Carpenters and Joiners of America, Local 579 v. Bradco Construction Ltd.*, [1993] 2 S.C.R. 316 at para. 43. What amounts to ambiguity? An ambiguity in the words in the document arises when a contract is "reasonably susceptible of more than one meaning:" *Hi-Tech Group Inc. v. Sears Canada Inc.* (2001), 52 O.R. (3d) 97 at para. 18 (C.A.). However, mere difficulty in interpreting a contract is not the same as ambiguity: *Northwestern Mechanical Installations Ltd. v. Yukon Contruction Co.* (1982), 37 A.R. 132 at para. 27.

In the face of ambiguity, the interpretation promoting a sensible commercial result is to be preferred: *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888; *Eli Lilly* at para. 56. In addition, the presence of ambiguity allows a court to apply the contra preferentum doctrine and interpret an ambiguous provision against the party who drafted it: *Consolidated Bathurst.*

In this case, clause 17.01 provided: "The Tenant will not assign this Lease in whole or in part, nor sublet any or all part of the Leased Premises, . . . without the prior written consent of the Landlord . . . which consent may not be unreasonably withheld." Both parties agreed that the meaning of this clause was clear and unambiguous.

Clause 17.03 provided: "In the event that the Tenant desires to assign, sublet . . . the Tenant shall give prior written notice to the Landlord of such desire . . . and the Landlord shall, within thirty (30) days thereafter, notify the Tenant in writing either, that: (i) it consents or (ii) does not consent as aforesaid to the assignment, subletting or parting with or sharing possession as the case may be, or (iii) it elects to cancel this Lease in preference to the giving of such consent." Both parties agree that the meaning of this clause was also clear and unambiguous.

The ambiguity, according to Bovar, came when trying to reconcile clauses 17.01 and 17.03 and give meaning to 17.01. However, Justice Brooker did not adopt Bovar's characterization of the problem as one of ambiguity. Instead, he held (at para. 44) that the problem was one of difficult interpretation only.

Justice Brooker was able to reconcile clauses 17.01 and 17.03 because of the phrase "in preference to the giving of such consent" in clause 17.03 (iii). At para. 49 he describes how both provisions can be given meaning:

> There are two options, i) and ii), that involve the Landlord's consent. As such, they invoke the requirement in Clause 17.01 that, should the Landlord withhold consent, such withholding must be reasonable. However, the third option, iii), gives the Landlord the right to cancel the lease in preference to the giving of such consent.

Justice Brooker takes the time to apply each principle of contract interpretation that he had outlined to the relevant provisions of the lease. He also deals with the precedents cited by the parties and the other arguments made by the plaintiff. Among the more interesting of the plaintiff's other arguments was the one that to adopt the interpretation that Justice Brooker did adopt in the end would lead to an absurd commercial result. Justice Brooker did not agree, of course. As he noted (at para. 68):

> In essence, the Defendant's option to terminate the contract instead of consenting to its transfer permitted it (rather than the Plaintiff) to get the benefit of the then current market lease rates. There is nothing commercially absurd about that. It was simply astute bargaining on the part of the Defendant - if market rates were less than lease rates at the time of a requested assignment, the Defendant could consent to the transfer and preserve the lease rate. If market rates were higher, the request for an assignment of the lease gave the Defendant the opportunity to terminate the lease and enter into another one at the higher current market rate, to its commercial advantage.

Astute bargaining indeed. Conor Pacific, the purchaser of Bovar's other assets, ended up entering into its own lease with the landlord at the market rate. In that lease, the rent was $15.00 per square foot, $9.00 more per square foot than the amount payable under the original lease with Bovar.