

COMMERCIAL LEASING UNDER THE NEW CIVIL CODE OF QUEBEC

FREDRIC L. CARSLEY

DE GRANDPRE CHAIT

1000 DE LA GAUCHETIERE STREET WEST

29TH FLOOR

MONTREAL, QUEBEC

H3B 4W5

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1. INTRODUCTION

In 1973, the Quebec government reformed the law respecting leases by adopting new Articles 1600 to 1649 of the Civil Code of Lower Canada ("CCLC"), which applied to leases generally and Articles 1650 to 1665.6 which applied specifically to residential leases.

Articles 1851 to 1891 of the Civil Code of Quebec ("CCQ") which came into force on January 1, 1994 are, in many cases, a reformulation of the 1973 reform. It is drafted in the context of the CCQ in general, with particular regard to the protectionist philosophy which pervades the spirit of the CCQ, signalling a shift from a more *laissez-faire* "protect yourself through the negotiating process" approach to a more status-oriented approach to private law dealings, which seeks to protect parties to the bargaining process who, due to their weaker positioning, require protection.

This paper will focus upon the CCQ articles that are most germane to commercial leases, the impact they will have upon the commercial leasing business in the future and the manner in which the Courts have applied them since 1994.

2. ORGANIZATION OF ARTICLES PERTAINING TO LEASES

2.1 Under CCLC

The CCLC divided the lease articles into three (3) sections:

- (a) rules applicable to all leases;
- (b) rules that are particular to the lease of an immovable; and
- (c) special provisions respecting the lease of dwellings.

2.2 Under CCQ

The CCQ creates only two (2) distinct categories. These are:

- (a) rules applicable to all leases, which, subject to specifically stated exceptions would apply to both movables as well as immovables; and
- (b) leases applicable to dwellings; a separate subcategory is created for special types of residential leases such as educational institutions (Articles 1979 to 1983) and leases in low cost housing projects (Articles 1984 to 1995).

2.3 Condensed Drafting Style

The CCQ has also reduced the number of articles by combining reciprocal types of obligations. For example, under the CCLC, Articles 1607 and 1618 respectively prohibited the landlord and tenant from changing the form or destination of the premises. Under Article 1856 of the CCQ, these obligations are combined as follows:

"Neither the lessor or nor the lessee may change the form or destination of the leased property during the term of the lease."

3. GENERAL CONTRACT RULES

3.1 Lease as Nominate Contract

The lease is one of several "nominate contracts" provided for in the CCQ. Article 1377 CCQ provides that the general rules set out in the chapter regarding contracts generally apply to all contracts, subject to certain special rules which complement or depart from these general rules.

No study of the rules governing commercial leasing would be complete, therefore, without an overview of some of the general rules of contract found in the CCQ which will profoundly impact upon the practice of commercial leasing in the future.

3.2 Offer and Acceptance

3.2.1 Importance of Offers in Commercial Leasing

Most commercial landlords prefer to initiate the transaction with an offer to lease or a letter of intent rather than the form lease. Offers are shorter, tend to focus more of the business aspects of the transaction rather than the so-called "boiler plate" clauses and tend to be negotiated and signed much more quickly than leases.

The accepted offer is a binding contract, which produces juridical effects and if the lease is never signed, which occurs all too frequently, is the only contract binding the parties.

Articles 1388 to 1397 CCQ contain a series of conditions dealing with offers and acceptance that apply to all types of offers, including offers to lease. Some of these create pitfalls that can be avoided by proper drafting.

3.2.2 Acceptance that "Substantially Corresponds"

Article 1393 of the CCQ states that:

"Acceptance which does not correspond substantially to the offer or which is received by the offeror after the offer has lapsed does not constitute acceptance."

The notion of "substantial correspondence" appears to be a codification of the existing law, as according to Professor Baudouin (now a justice of the Quebec Court of Appeal), acceptance of the essential elements of an offer is sufficient. This may then lead to a dispute as to what constitutes a primary or essential condition as opposed to what is known as a "secondary term".

To avoid this problem, offers to lease should contain a clause which stipulates that if any change is made to the offer, the acceptance is not valid, even when the acceptance would correspond substantially to the offer. This clause should be stated as being an essential one.

3.2.3 Delay for Acceptance

Article 1392 CCQ provides that if the offer stipulates no delay for acceptance, the offeree is given a reasonable delay to accept the offer.

In practice, it is often difficult to determine if a reasonable delay has expired, as all of the extenuating circumstances must be considered. Where the landlord wishes to withdraw the offer in order, for example, to lease the premises to another tenant that is not prepared to wait for a court to determine whether or not a reasonable delay has expired, the decision to declare that the offer has lapsed may prove difficult and risky.

The prudent offeror will avoid these problems by stipulating a precise delay to accept the offer.

3.3 The Contract of Adhesion

3.3.1 Definition

The CCQ legislates the civil law notion of the contract of adhesion. It is defined in Article 1379 CCQ as follows:

"A contract of adhesion is a contract in which the essential stipulations were imposed or drawn up by one of the parties, on his behalf or upon his instructions, and were not negotiable."

Standard leases, standard offers to lease, standard franchise and affiliation agreements, standard guarantees or indemnity agreements and other contracts which are frequently used in the day to day business of commercial leasing may, depending upon the circumstances, constitute contracts of adhesion.

Whether or not a contract is an adhesion contract will be a factual determination.¹ It is unlikely that self-serving statements in agreements that declare the contract not to be an adhesion contract will be taken seriously by the Courts. However, a clause stipulating that the tenant was given the opportunity to negotiate the essential conditions of the agreement may be helpful, particularly if the tenant is represented by counsel, or is experienced in commercial leasing generally, such as the chain store retail operation.

3.3.2 Special Rules Applicable to Adhesion Contracts

In keeping with the CCQ's overall philosophy to protect the weaker of the contracting parties, special rules apply to adhesion contracts and to consumer contracts. In grouping adherents with consumers, the legislature appears to favour extending consumer-type protections to those contractants not able to protect themselves in any meaningful manner.

(a) Contra Proferens

In cases of doubt, the contract will always be interpreted in favour of the adherent (Article 1432 CCQ).

¹ See for example *Groupe Jean Coutu (PJC) Inc. v. Tremblay*, J.E. 97-1097, where, on the basis of the evidence presented, a lease and a guarantee did not qualify as a contract of adhesion.

(b) **Illegible or Incomprehensible Clauses**

Illegible or incomprehensible clauses will be null if the debtor suffers prejudice, unless the creditor proves that they were adequately explained to the debtor (Article 1436 CCQ).

Minuscule print is an obvious example of an illegible clause.

Incomprehensible clauses are usually the product of poor draftsmanship, something which is every contractual lawyer's nightmare.

(c) **External Clauses**

External clauses, that is, clauses which incorporate other agreements by reference, will only be binding in adhesion contracts if the creditor can prove that the external clause was either brought to the adherent's attention or that the adherent knew about it (Article 1435 CCQ).

An appropriate example of an external clause might be a clause typically found in landlord-oriented offers to lease stating that "the landlord's standard lease is deemed to form part of this offer." Clearly this is an external clause and if the offer is an adhesion contract, the landlord must prove that the tenant was familiar with the lease. One method to achieve this is to attach a copy of the standard lease to the offer. In practice, this often makes the offer difficult to negotiate and conclude, especially when the landlord's objective is to have the tenant take occupancy as quickly as possible but insists, and rightly so, on having a signed agreement from the tenant beforehand.

Another method may be to give the tenant a copy of the lease before the tenant signs the offer and draft into the "lease clause" language whereby the tenant declares to have received a copy of the lease, has read it and is satisfied with its contents.

(d) **Abusive Clauses**

Abusive clauses may be declared null or may be modified. Article 1437 CCQ defines an abusive clause as:

"A clause which is excessively and unreasonably detrimental to the adhering party and is therefore not in good faith; in particular, a clause which so departs from the fundamental obligations arising from the rules normally governing the contract that it changes the nature of the contract is an abusive clause."

Rights given to landlords or tenants to act arbitrarily or unreasonably, rights given to landlords to terminate leases or to increase the rents on assignments, subleases or changes of control, rights to relocate the tenant to a location the landlord selects and with no compensation payable to the tenant, exorbitant penalty clauses and contractual renunciations of legal rights, such as the right to terminate a guarantee after three (3) years contained in Article 2362 CCQ, all may be considered abusive if the contract is an adhesion contract.

Penalty clauses are legal in the Quebec Civil Law but, pursuant to Article 1623 C.C.Q., may be judicially modified if held to be abusive, whether or not the contract is an adhesion contract. For example, a clause requiring the tenant to pay the balance of the rent due after

default as damages and a clause requiring the tenant to pay an administration fee of fifteen percent (15%) of the total default were both reduced substantially.² The Court reasoned that although the clauses were not illegal, in the circumstances the amounts involved greatly exceeded the prejudice suffered and ought to be reduced.

3.4 The Obligation to Act in Good Faith

Another principle of law which is new to the code but, as recent case law has demonstrated, is not new to the law of Quebec, is the basic obligation to act reasonably and in good faith. The new code is replete with general and specific expressions of this basic notion. A few examples are:

Article 6 Every person is bound to exercise his civil rights in good faith.

Article 7 No right may be exercised with the intent of injuring another in an excessive and unreasonable manner which is contrary to the requirements of good faith.

Article 1375 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.

The doctrine of fair dealing in commercial leasing, which has been developed in the United States and Common Law Canada has found favour with Quebec judges.³ For example, a landlord who refused to grant its consent to the subleasing of industrial premises, proceeded to negotiate with the subtenant in the hope of extracting some financial consideration from the subtenant which would otherwise be payable to the head tenant and when unsuccessful in doing so, purported to exercise a cancellation right contained in the lease was said to have acted abusively and arbitrarily.⁴ Similarly, where a franchisor operated a competitive business to that of its franchisee in the same market but due to various provisions of its affiliation agreements, refused to allow the franchisee to effectually compete on price, advertising and marketing strategies, the franchisor was held to have acted abusively and was condemned to pay over \$2,000,000 in damages.⁵

The corporate law concept of "lifting the corporate veil" has also found its way into the CCQ in Articles 316 and 317 where a fraud has been perpetrated. An interesting example is found in the case of *131364 Canada Inc. v. Investissement GMHI Inc.*⁶ A retailer operated a store in one municipality and opened a second store in a neighbouring municipality in a property owned by an affiliate of the first landlord, using the same corporate entity as the tenant in both cases. Losses from the second store began to deplete earnings from the company as a whole. The principals of the company met with the landlord of the unsuccessful store on three successive occasions and, after having explained their financial difficulties, negotiated important lease concessions predicated on the tenant not closing the

² *Groupe Jean Coutu (PJC) Inc. v. Tremblay*, *supra* note number 1.

³ For a detailed comparative law analysis, see Carsley, Fredric L., Good Faith and Fair Dealing in the Commercial Context, Comparative Law Yearbook of International Business, Klumer Law International, pages 233 to 248.

⁴ *Les Immeubles Francana Limitée v. Farbec Inc.*, S.C.M.: 500-05-001428-877, upheld in appeal, J.E. 96-1260.

⁵ *Supermarché ARG v. Provigo Distribution Inc.*, [1995] R.J.Q. 464, upheld in appeal (but quantum of damages reduced): [1998] R.J.Q. 47.

⁶ J.E. 95-1710.

store. Concurrently, the principals restructured their affairs corporately such that the assets were now found in an entity that operated the first store but not the second store. The landlord was then left with an asset-barren tenant and took proceedings against the directors and shareholders for damages, alleging bad faith.

The court found that the manner in which the principals of the company reorganised their affairs was done deliberately to avoid that company's contractual obligations to the second landlord. The prime reason for restructuring was so that good assets would not be available to answer for the losses of the second store. By re-structuring matters in such a way (albeit to permit the successful store to survive and not be jeopardised by the poor location), especially after having enticed the landlord to grant concessions, the directors were found to have acted in bad faith and were held personally liable for the landlord's losses. Acting in bad faith was held to be an abuse of right, sufficient to pierce the corporate veil.

3.5 Transitional Rules

How does the CCQ apply to existing leases, offers and other similar agreements in effect on January 1, 1994 when the CCQ was proclaimed into force?

On December 18, 1992, the Quebec National Assembly adopted an Act Respecting the Implementation of the Reform of the Civil Code (SQ 1992, Chapter 57) ("Transitional Act"). The general principle of the Transitional Act is that the CCQ is not to have retroactive effect, but subject to specific transitional rules, applies to pre-1994 contracts.

The CCQ applies to existing contracts in respect of the exercise of rights and the performance of obligations and in respect of their proof, transfer, alteration or extinction. In certain cases, the law will retroact. For example, Article 1432, 1436 and 1437 CCQ, being some of the provisions affecting contracts of adhesion, will apply to obligations occurring prior to as well as after January 1, 1994, through the application of Articles 81 and 82 of the Transitional Act.

There are no specific transitional rules which apply to the commercial lease other than a right to convert the landlord's privilege into a legal hypothec for a maximum of ten (10) years, which will be discussed under Section 4.5.4 of this paper.

4. CHANGES AND INNOVATIONS TO THE RULES REGARDING COMMERCIAL LEASES

4.1 General

We now turn to the CCQ articles dealing specifically with leases.

As noted above, the CCQ articles apply to leases of both movables and immovables except where otherwise stated. For example, Article 1853 CCQ declares that a lease of movable property is not presumed while the lease of immovable property is presumed where a person occupies the premises by sufferance of the owner.

4.2 Basic Obligations

4.2.1 Definition of a Lease

As in the past, a lease is a contract by which the landlord undertakes to provide peaceable enjoyment of movable or immovable property for a certain period of time in return for the payment of rent. Note that under Article 1600 CCLC, the rent is the "consideration" for the contract while under Article 1851, no mention is made of consideration. This is consistent with the general contractual rule enunciated in Article 1371 CCQ which, unlike the CCLC, no longer speaks of "consideration" as a constituent element of the formation of a contract, but requires a "cause which justifies its existence". This is not a substantive change in the law but rather, is one of nomenclature.

4.2.2 Term

(a) Maximum 100 Years

The term of the lease may be fixed or indeterminate; however, pursuant to Article 1880 CCQ, the term may not exceed one hundred (100) years and if it does, then the term is automatically reduced to one hundred (100) years.

This makes leases consistent with other long-term agreements, such as emphyteusis (Article 1197 CCQ) and usufruct (Article 1123 CCQ), where the maximum term is one hundred (100) years.

This is distinguishable from the right of superficies which, unless the constituting act creates a term, may be perpetual (Article 1113 CCQ), although for practical purposes, it is likely that fixed terms would be created.

The limitation of one hundred (100) years puts an end to the controversy in the jurisprudence as to whether or not there can be a perpetual lease.⁷

Does the one hundred (100) year maximum include or exclude renewal options? Leases for department stores in major regional shopping centres sometimes contain an initial term and renewal options which in the aggregate would exceed one hundred (100) years. Will the notion of "term" contemplated in Article 1880 CCQ include the renewal period and restrict the total term to one hundred (100) years? One might argue by way of contrast that in *the Act Authorizing the Municipalities to Impose Duties of Transfers of Immoveables*⁸ which imposes "mutation taxes", the definition of a "transfer" includes a lease with a total term, with or without options, exceeding forty (40) years. Might the department store argue that the notion of "term" in Article 1880 CCQ is not intended to apply to renewals? Obviously, the safer position would be to have the leases structured so as having a maximum term expiring in one hundred (100) years.

(b) Indeterminate Terms

⁷ See for example *Cyclorama de Jérusalem Inc. v. Congrégation du Très Saint-Rédempteur* [1964] S.C.R. 158.

⁸ RSQ 1991 chapter D-15.1. Note that as of January 1, 1992, transfer duties are 0.5% of value up to \$50,000, 1% of value on the next \$200,000 and 1.5% of value in excess of \$250,000. Note as well that emphyteusis, being neither a lease nor a transfer of ownership, but rather a dismemberment of property rights, is considered by the Quebec Department of Justice and by the land registrars to be free of mutation tax.

Indeterminate terms are cancellable with the same notice provisions as in the CCLC, that is, depending upon how the rent is payable.

Leases may be tacitly renewed as in the past, save that the eight (8) day delay for the landlord to protest the continued occupancy contained in Article 1641 CCLC has been increased to ten (10) days in the Article 1879 CCQ. Tacit renewal does not appear to be of public order and commercial leases should continue to contract out of the tacit renewal process.

4.2.3 Publicity of Rights

(a) Nature of Protection

The CCLC notion of "registration" is replaced in the CCQ by what will be known as "publicity of rights".

As a general rule the former registration system gave effect to real rights (See Article 2082 CCLC). The rights of a tenant under a lease were, and continue to be personal rights, as opposed to real rights but by exception, the CCLC permitted registration of leases, either at length or by memorial.

While the traditional distinctions between personal and real rights are perhaps not as rigid under the new legal system, Article 2982 CCQ limits the information that may be registered to the information prescribed by regulation. The regulations are lengthy, detailed and exacting as to form. Tenants with leases of longer than one (1) year must register to avoid a subsequent acquirer or a hypothecary creditor of the property exercising the right under Article 1887 C.C.Q. to terminate the lease.

(b) How to Register

Immovable leases may be registered by summary in the land registry. The summary must be prepared on 8 ½ x 14 inch paper, respecting registry office margins and tumbled and must be certified by the notary or advocate preparing the summary.

Articles 2988 and following of the CCQ detail the certification requirements for registrations in the land registry. Article 2991 CCQ obliges the notary or attorney preparing the summary to attest to the fact that he has verified the identity, quality and capacity of the parties, the validity of the deed as to its form, the validity of the title and that the document represents the will of the parties. Article 2992 CCQ also requires that the advocate or notary attests that the summary is accurate.

Lease practitioners find the Article 2991 CCQ burden both difficult and risky to discharge. However, the second paragraph of Article 2995 CCQ provides that if the lease is executed before two (2) witnesses and an affidavit of execution is attached (much like the former system), the certification is not required. The land registry in Montreal is interpreting this provision to mean that if the lease is executed before two (2) witnesses and has the affidavit, the major certification stipulated in Article 2991 CCQ will not be required, but the draftsperson will be required to certify that the summary is accurate as required by Article 2992 CCQ.

As is the case with other land registry documents a copy of the document the summary summarized must be deposited with the registrar "for conservation and consultation". This has proven to be unsatisfactory for both landlords and tenants alike, who wish to keep the rentals confidential and were able to do so under the previous system by not mentioning them in memorials.

Various suggestions that have been made to circumvent this problem include:

- (i) prohibitions to publish, which, as a result of Article 2936 CCQ would seem to be contrary to public order and unenforceable;
- (ii) placing the rents in a schedule to the lease and depositing the lease without the schedule, which might be quite a risky solution. A subsequent acquirer or hypothecary creditor taking in payment may challenge the validity of the registration on the basis that the rent, being the most fundamental obligation of the tenant under the lease was not made available for "conservation and consultation" as required by Article 2985 CCQ;
- (iii) executing the lease in notarial form, having the notary summarize an extract of the lease and present the extract with the summary to the registrar. This will likely be expensive and impractical for major landlords with hundreds or thousands of tenants;
- (iv) executing a short form of lease which, in the form of a contract, provides the information contained in the pre-1994 memorial.

Many practitioners opted for the short form of lease, only to discover in a 1997 decision⁹ that is to be an invalid registration. In March 1998, the Urban Development Institute of Quebec, the International Council of Shopping Centres and the Retail Council of Quebec made a joint submission to the Quebec Government to change the law, supported by several major retailers. The submission received a favourable reception from justice officials, but a final answer has not yet been received.

(c) **Opposable Rights**

The object of the registration system is to publicize rights and make them opposable against third parties.

Article 2934 CCQ envisages publication of both personal as well as real rights and Article 2941 CCQ confirms the basic principle of the opposability of published rights against third parties.

Article 1852 CCQ is new to the code. In 1994, it stated "the rights resulting from the lease may be published". In 1998, the article was amended to give effect to the registration of various types of movable securities.

⁹ *Banque de Développement du Canada v. 2645-7077 Quebec Inc. et al* 540-05-003125-972.

What are the rights granted under a lease of an immovable that may be opposable by publication?

(i) Peaceable Enjoyment

Clearly the right to peaceably enjoy the premises for the term is the tenant's primary right. However, it is submitted that if this was the only right which was envisaged by the legislature, then there would be no need to add Article 1852 to the CCQ, as Article 1887 CCQ re-states the essential elements of Article 1646 CCLC.¹⁰

(ii) Options and Rights of First Refusal to Purchase the Property

Often a tenant of all or a substantial part of a building obtains in the lease an option or a right of first refusal to acquire the property and registers this right on title. If the landlord sells or attempts to sell the property in violation of the option or right, can the tenant make the option or right opposable to the acquirer and successfully attack the sale?

Most judgements on the subject have concluded that the option or right of first refusal is not opposable to the third party, even if registered, as it is not a real right and, although it is contained in the lease, is really a separate contract.¹¹

Suppose the tenant stipulates in the lease that the option or right of first refusal is an essential condition to the tenant having leased the premises, failing which it would have never done so. Clearly, if the landlord wished to alienate the property, then the tenant would want to make a decision as to whether it preferred to remain as a tenant or simply be an owner. It might be argued that these are rights then emanating from the lease to which Article 1852 CCQ would apply, such that if an option or right of first refusal is published, it is at least arguable that the right should be opposable to third parties.

(iii) Restrictive Lease Covenants

What about rights which are directly related to the tenant's business, such as exclusivity rights and other restrictive covenants granted to the tenant?

One of the most difficult problems facing a tenant whose exclusivity has been violated is enforcement against the offending tenant. It is possible that the offended tenant may seek to resiliate (the civil law remedy for terminate as a result of a default) the lease and claim damages for breach of the landlord's obligations; however, if the tenant is insisting upon its exclusivity, it probably desires to remain in business in the premises with its privileged exclusivity position.

Quebec courts have held on several occasions that although there is no contractual *lien de droit* (the civil law equivalent of the common law doctrine of privity of contract) between a tenant with the exclusivity and the offending tenant, where the tenant with the exclusivity can prove that the offending tenant had knowledge of the exclusivity, then an injunction

¹⁰ See Section 4.2.3(d) *infra* for a discussion on the necessity of obtaining non-disturbance agreements.

¹¹ See for example *Robert v. Turgeon*, 38 R.P.R 173 on options; *Cadieux v. Hinse* [1989] R.J.Q. 353 and *Odell v. O'Brien Reynold* S.C.M. 500-05-000593-895 on rights of first refusal.

would lie to restrain the offending tenant from breaching the exclusivity for having committed a delictual fault.¹² The situation is more onerous on the tenant with the exclusivity where knowledge of the exclusivity cannot be proved. This was demonstrated in the case of *Place Versailles Inc. v. Maison de Choix Inc.*,¹³ where, while an injunction was granted against the landlord to cause an offending tenant to cease violating an exclusivity, the injunction was not granted against the offending tenant as it had no knowledge of the restrictive covenant and was simply operating its business in accordance with the terms of the use clause in its lease.

Could a tenant with an exclusivity successfully prove constructive knowledge by publicizing (registering) the exclusivity clause on title? In some common law jurisdictions, this technique appears to be available where the exclusivity is considered to be a covenant which "runs with the land". For example in *Russo v. Field*,¹⁴ the Supreme Court of Canada held that the registration of a notice of lease under the Ontario Land Titles Act,¹⁵ created constructive notice of the terms of the lease. A Manitoba court refused an interim injunction against a competing tenant even though the landlord had granted an exclusivity clause to the original tenant because the original tenant had not registered the restrictive covenant.¹⁶

It may well be arguable that exclusivities are rights under the lease and if they are registered, the registration of an exclusivity may constitute constructive notice to third parties. This should allow the tenant with the exclusivity to seek injunctive relief from the offending tenant.

If this is the case, then tenants (or counsel acting for tenants) should do verbal searches of the various registers where these rights may be registered and as well, request that the landlord warrant that there are no leases or other agreements which would restrict the rights of the tenant from operating its premises for the permitted use. Landlords (or counsel acting for them) should seek to require that tenants respect existing exclusivities, especially where a tenant may have a very wide and liberal use clause, such as for example, the right to use the premises "for any purpose not prohibited by law". Frequently in these situations, the tenant is asked to respect the existing exclusivities and the landlord is asked to exempt that tenant from the ambit of any future exclusivity which the landlord may choose to grant in the future.

(d) **Non-Disturbance Agreements**

Under the previous system, tenants registered leases at length or by memorial to protect themselves against subsequent acquirers and subsequent ranking hypothecary creditors exercising rights to terminate leases under Article 1646 CCLC. To protect themselves against hypothecary creditors whose rights were registered prior to the lease, tenants would seek non-disturbance agreements directly from the hypothecary creditors, whereby the creditors would agree to respect the tenant's rights and, if asked, sometimes would even agree to perform the landlord's obligations should they take possession, subject to certain exceptions such as a refusal by the lender to do work, pay inducements, or be responsible for defaults of the landlord that occurred prior to the lender taking possession.

¹² See for example *Serabec Ltée v. Place Desjardins Inc. and Provisoir Inc.* 500-05-022897-760; *Wise Brothers Ltd. v. Nortree Development Ltd. et al* [1983] C.A. 501.

¹³ [1967] B.R. 87.

¹⁴ [1973] S.C.R. 466.

¹⁵ R.S.O. 1960 c. 204 as amended.

¹⁶ *Lo-Cost Drugmart Ltd. V. Daon Developpment Corp.* (1986) 26 D.L.R. (4th) 620 (Man. C.A.).

Article 1887 CCQ is similar, although not identical to Article 1646 CCLC. Article 1887 CCQ affords at least the same protection for the registered lease. Correspondingly, the same sanction for the unregistered lease would apply.

A contrary argument has been raised where a hypothecary creditor takes the property in payment (*prise en paiement*) following a default, as Article 2783 C.C.Q. appears to restrict the extent to which the creditor may retroactively purge existing rights. However, at least two (2) judgements¹⁷ have held that Article 1887 C.C.Q. did not change the law on these matters, and the tenants lost their leases. Consequently, tenants registering after a mortgage should continue to obtain non-disturbance protection.

Article 1646 CCLC applied to resolutive clauses in deeds of sale as well as dation en paiement clauses in deeds of loan. Article 1743 CCQ stipulates that when the seller resolves the sale pursuant to a resolutive clause, it takes back the property free and clear of all charges which the buyer may have placed upon it after the seller registered its rights. Consequently, if a resolutive clause exists, the tenant should obtain non-disturbance protection from the seller or, if the seller has assigned the balance of price and the security, from the assignee.

4.3 Specific Obligations

4.3.1 Warranty on Use

The second paragraph of Article 1854 CCQ is new to the code. It obliges the landlord to warrant "that the property may be used for the purpose for which it is leased". This goes beyond the existing warranty of "trouble de droit", which warranty is provided for in Article 1858 CCQ.

This new warranty would appear to be a codification of existing jurisprudence on zoning and other matters adversely affecting the tenant's ability to use the premises for the intended purpose which would cause the tenant a serious prejudice. An example occurred in the case of *157531 Canada Inc. v. Tilli*,¹⁸ where a tenant in the business of manufacturing concrete fences expecting to store its materials upon the exterior lot which formed part of the premises was unable to do so due to prohibitive zoning regulations. This materially inhibited the tenant's operations and justified the rescission of the lease.

4.3.2 Maintaining for the Purpose

The second paragraph of Article 1854 CCQ continues by stating that the landlord is obliged to "maintain the property for that purpose throughout the term of the lease". The notion of "maintenance" here is a curious one. Does the term "maintain" (in French "de l'entretenir") mean maintenance in the sense of repairs, or is it a continuing obligation on the part of the landlord to ensure that the premises may, in a zoning sense, be used for the intended purpose? It is submitted that the legislature intended the former¹⁹. For example, if a new

¹⁷ *Caisse populaire Desjardins de St-Jacques v. 110765 Canada Ltée* [1995] R.D.I. 188; *Importations de Mode Neera Inc. v. 9014-2563 Quebec Inc.*, [1997] R.D.I. 399.

¹⁸ S.C.M. 505-001020-987.

¹⁹ See *Michel Barbeau v. Françoise Bérubé* [1995] R.L. 195, where Article 1854 C.C.Q. was used to reinforce a landlord's obligation to do major repairs to an apartment. See also *Bourget v. Houle*, J.E. 96-1849, where the maintenance obligation contained in Article 1854 required effecting normal and

by-law requires effecting work to the premises to make the premises comply, the landlord would be obliged to do this work. It is also submitted that this obligation is not of public order insofar as commercial leases are concerned and landlords, particularly with net net leases, may wish to specifically contract out of this obligation.

4.3.3 Disclaimers on Zoning

Leases often contain clauses whereby the tenant declares that it is satisfied with the zoning and other matters and stipulates that the tenant will have no recourse against the landlord, even if the premises cannot be used for their intended purposes. Will the courts consider the first part of the second paragraph of Article 1854 CCQ to be of public order and hold that disclaimer clauses of this nature are null? In the light of the protectionist nature of the CCQ, the courts may be inclined to take a dim view of such disclaimers, especially if the failure to operate as the result of restructured zoning effectively denies the tenant peaceable enjoyment, which goes to the essence of lease.

This may place a greater burden on landlords to satisfy themselves that the premises can be used for their intended purposes.

When the landlord has acknowledge of a zoning problem but fails to disclose the problem to the tenant, Quebec Courts will not enforce zoning disclaimer provisions.²⁰ The same result was reached where the tenant itself investigated the zoning, but the landlord withheld pertinent information.²¹

This may cause lenders financing the real estate to ask similar questions and impose warranties or other obligations upon their borrowers to ensure that the leases being assigned to them as security for the loans will not be invalidated for zoning and use reasons.

4.3.4 Change of Form or Destination

The CCQ perpetuates the obligations imposed by the CCLC on both the landlord and the tenant not to change the form or destination.²² This will render applicable existing jurisprudence, which, in recent years has created an obligation on the part of the landlord to operate a shopping centre and use its best efforts to lease out vacant space and not encourage other tenants to vacate premises²³ and on the part of the tenant to continuously operate its premises in circumstances in which continuous operation is warranted.²⁴

4.3.5 Trouble de Fait et Trouble de Droit

reasonable repairs, but did not require the landlord to do special sound proofing to account for a tenant's particular physical ailments.

²⁰ See for example *Tremblay v. Tremblay*, J.E. 96-400.

²¹ See for example *Gestions Solvic Ltée v. Amusements Daniel Inc.*, J.E. 96-298.

²² For an in-depth discussion of change of form or destination, See Carsley, Fredric L., *Restrictive Covenants, Non-Competition Clauses and Changes of Form or Destination in Commercial Leases*, 1989 McGill University Faculty of Law Meredith Memorial Lectures, at pages 123 to 155.

²³ *Société Investissement York Hanover Ltée v. B.M.P. Steerburger House Inc.* S.C.M. 500-05-000234-797.

²⁴ See for example *Compagnie de Construction Belcourt Ltée v. Golden Griddle Pancakes House Ltd.* [1988] R.J.Q. 716, *Les Galeries de la Capitale Inc. v. Elks Inc.*, S.C.M. 500-05-010680-906, *Place Bonaventure Inc. v. Imasco Inc.*, S.C.M. 500-05-002246-930, *Place Bonaventure Inc. v. Banque Nationale du Canada*, J.E. 98-1301.

The landlord continues to be bound to warrant the tenant against *troubles de droit* (Article 1858 CCQ). The tenant may not exercise its recourses for *trouble de droit* until it first notifies the landlord of the disturbance.

The landlord is not liable for "*trouble de fait*" and the landlord is generally not liable for acts of third persons, but may be liable where the third person is a tenant of the property or a person whom the tenant allows to use or have access to the property (Article 1859 CCQ). Note that this applies both to movables as well as immoveables.

4.3.6 Repairs

The landlord continues to be liable for major repairs. This does not appear to be of public order and may be contracted out of in commercial leases.

Under the CCLC, if a landlord is in default to fulfil its repair obligations, the tenant may, by way of motion to the court, request permission to make the repair at the expense of the landlord and to withhold the rent to cover the cost. Under Article 1867 CCQ, the tenant retains this right.

Article 1868 CCQ, which is new, also allows the tenant to undertake repairs that are urgent and necessary, without court authorization, where the tenant "has attempted to inform the lessor, or has informed him but the lessor has not acted in due course". The tenant is then entitled to reimbursement of the reasonable expenses it incurs and is entitled to withhold the rent until they are paid.

This is both expeditious and practical for the tenant and certainly will assist tenants in basic situations, such as where the landlord is not clearing the snow from the parking facilities or is not paying its utility bills and the tenant finds that there is no electricity or gas being supplied to the premises. However, before spending the money and withholding the rent, the tenant should satisfy itself that the repair is really one for which the landlord is responsible and that it is urgent and necessary, as it may have to prove that it has properly exercised its right under Article 1868 CCQ.

Tenants who have waived compensation (set-off rights) may find this waiver to impede them from reimbursing themselves for the cost of having exercised the self-help remedy. A recent decision²⁵ upheld the waiver of set off in a commercial lease, obliging the tenant to take a new action against the landlord to be reimbursed for the cost of repairs.

4.3.7 Entry By the Landlord

The second paragraph of Article 1865 CCQ will allow the landlord to require the tenant to temporarily vacate the premises while repairs are being made, provided however that if the repairs are not urgent, then the landlord must obtain court authorisation before doing so. This right applies to making urgent and necessary repairs but may not necessarily apply where the landlord is merely doing work of a voluntary nature in the premises (such as for example, doing work in the premises that might be required or be desirable for other parts of the property). Landlords would be well advised to contractually stipulate the right to force the tenant to vacate during times that these repairs are being made.

²⁵ *Assurance-vie Desjardins Laurentienne Inc. v. Candev Construction Inc.*, J.E. 98-913.

4.3.8 Relocating a Tenant's Premises

The CCQ, like the CCLC, does not address relocations. The Civil Law position, as recently expressed by the Courts²⁶, is that without a relocation clause, the landlord has no right to force the tenant to move. Even if the move would be beneficial to the project as a whole, to force a relocation against a tenant's will has been viewed by Quebec Courts as an expropriation by the landlord.

4.4 Assignment, Subletting and Change of Control

4.4.1 Generally

Significant changes have been made in the area of assignments of lease and subletting of premises. It should be noted that a change of corporate control is not provided for in the CCQ. While to the best of the writer's knowledge there are no Quebec decisions on the point, there is American²⁷ and common law Canadian²⁸ case law authority to support the proposition that a change of corporate control is not the equivalent of an assignment or a sublease and any statutory restrictions upon assignment and subletting would not apply to change of corporate control. Therefore, landlords wishing to control transfers by means of change of corporate control must continue to do so contractually.

4.4.2 Absolute Prohibitions

Prior to 1973, the tenant was given the right to assign or sublet, unless the lease stipulated otherwise.²⁹ It was felt that absolute prohibitions to assign or sublet were not illegal, but where the landlord's consent was required, it had to be exercised reasonably.

As part of the 1973 reform, Article 1619 CCLC was supposed to ensure that landlords acted reasonably in refusing consents. In fact, the provision was drafted in a manner that was somewhat restrictive from the tenant's perspective, by stating in the first paragraph:

*"The lessee **cannot** sublet all or part of the thing or assign his lease without the consent of the lessor, who cannot refuse it without reasonable cause." (Emphasis added)*

Article 1870 CCQ appears to create more of a right in favour of the tenant than a restriction, subject of course to obtaining the landlord's consent. Article 1870 CCQ states:

*"The lessee **may** sublease all or part of the leased property or assign his lease. In either case, he is bound to give notice of his intention and the name and address of the intended sublessee or assignee to the lessor and to obtain his consent." (Emphasis added)*

²⁶ *Société de Gestion Clifton Inc. v. Triad*, J.E. 96-1264.

²⁷ For example: *Posner v. Air Brakes & Equipment Corporation*, (1948) 62 A.2d 711 (New Jersey Superior Court) and *Alabama Vermiculite Corporation v. J.J. Patterson* (1954) 124 F. Supp 441).

²⁸ For example: *Dominion Stores Ltd. v. Bramalea Ltd.*, 38 R.P.R. 12.

²⁹ Former Article 1638 CCLC.

With this apparent change in the text and given the protectionist nature of the CCQ, one wonders if the courts would uphold an absolute prohibition against assignment or subletting. For example, in the case of *Family Life Assurance Co. v. Crecco*,³⁰ the court held that where a lease contained a clause prohibiting assignments or subleases, the tenant was simply prohibited from doing so and the landlord was not required to give any reason for refusing its consent. While the *Crecco* decision has been criticized in doctrinal writing as being contrary to the basic obligation to act reasonably,³¹ it does not appear to have been overruled judicially. However, with the protectionist philosophy of the CCQ, *Crecco* may be decided differently today.

4.4.3 A Serious Reason

Article 1871 CCQ stipulates that the landlord may not refuse its consent without "a serious reason". The French text uses the phrase "un motif sérieux". Given the body of jurisprudence which exists that has interpreted the concept of "consent not to be unreasonably withheld" in assignment and subletting situations, it is surprising that the legislature did not use the "reasonable cause" test contained in the CCLC. However, it is submitted that for practical purposes, there should not be much, if any, difference between the two notions.

4.4.4 Justifying the Refusal

The second paragraph of Article 1871 CCQ requires that the landlord motivate the grounds upon which he was refusing his consent. It states:

*"If he refuses, he is **bound** to inform the lessee of his reasons for refusing...". (Emphasis added)*

It is submitted that this is of public order and may serve to invalidate clauses which purport to give the landlord the right to act arbitrarily or in its sole and unreviewable discretion.

4.4.5 "Deemed Reasonables"

A practice has developed in many form leases, particularly for shopping centres and office buildings, whereby the landlord lists a series of reasons which the parties agree in advance will be deemed as reasonable cause to refuse consent. This practice, which has recently been approved of in the case of *Les Immeubles Bleury Dorchester Inc. v. Banque Nationale du Canada*,³² should be continued and perhaps the matters listed should be re-examined and expanded.

However, unreasonable provisions may not be upheld by the courts, despite the fact that the lease purports to "deem" them to be reasonable.

One area which is becoming more and more prevalent is the so called "cross-default" notion, whereby if a tenant is in default under one lease it will be deemed to be in default

³⁰ J.E. 82-846 (C.S.).

³¹ See arguments of Professor Pierre-Gabriel Jobin, (pages 102 to 106 *Le Louage de Chose*, 103) Les Éditions Yvon Blais Inc., (1989).

³² J.E. 98-56.

under another lease, usually either with the same landlord or with a company which manages the two (2) properties in question. The "deemed reasonable" list has, in many cases been expanded to include defaults either by the assignor or assignee under a related or connected lease, and this practice should continue as well.

4.4.6 Delay to Advise

Under the CCLC, unless the landlord responded within fifteen (15) days of the receipt of the request to assign or sublet, the landlord was deemed to have consented to the request.

In the first reading of Bill 125 (which eventually developed into the CCQ), the delay was reduced to ten (10) days. As a result of interventions made by the Bar of Quebec and other groups, the delay was re-established at fifteen (15) days.

For many landlords, fifteen (15) days may not long enough to determine if the assignee or subtenant is acceptable. In these cases the delay should be extended contractually.

4.4.7 Release of Assignor on Assignment

Under the law existing prior to January 1, 1994, the assignor was not released from its obligations under the lease unless the landlord specifically agreed to the release. In fact, most leases stated that if the lease was assigned, then the assignor must remain jointly and severally liable for the obligations of the tenant under the lease. Most collateral assignments of lease and hypothecs on rents used by real estate lenders provide, among other matters, that in the event of an assignment of the lease, the landlord is not permitted to release the assignor from its obligations without the lender's consent.

Article 1873 CCQ introduces a new concept into the law. It provides that an assignor is automatically released from its obligations under the lease, save that in the case of commercial leases, the lease may validly provide otherwise. Clearly it will be crucial for landlords to contract out of the effects of Article 1873 CCQ in any lease, offer to lease or any other leasing agreement for commercial premises.

In many cases, while the leases themselves deal with the issue satisfactorily, the offers to lease are silent on the matters of assignment and subletting. As occurs all too frequently in practice, the leases are not executed for a considerable length of time or may in fact never be executed and the parties are governed by the terms of the offer to lease. This could prove disastrous for a landlord, who, believing that it has contracted with an "asset company" finds that the tenant has assigned the lease to a no asset shell (whether it be related or unrelated to the tenant) and is left with little or no security for the payment of rent and the fulfilment of other obligations of the tenant under the lease. Landlords should ensure that their offers and other similar contracts contain assignment and subletting clauses that contract out of the release provided for in Article 1873 CCQ.

It should be noted that in the first draft of the CCQ (then Article 1861), the release would only apply in the circumstances where the assignor was obtaining the landlord's consent. Under Article 1873 CCQ as finally enacted, the release applies in any circumstances where an assignment is being made. This could apply even where assignments are permitted without the landlord's consent, such as assignments to related corporations, assignments to

a purchaser of a larger business and other assignments which the landlord agrees to permit without having to obtain its consent.

4.4.8 Subleases

The rules regarding subleases have been modified considerably.

(a) Basic Legal Notions of Subleases

A sublease is a "lease within a lease" where the sublandlord/head tenant grants peaceable enjoyment to the subtenant on the terms and conditions of the sublease.

There is no contractual *lien de droit* between the head landlord and the subtenant, although Article 1638 CCLC extended the landlord's privilege to the moveable effects located on the premises that belonged to the subtenant to the extent that the subtenant was indebted to the head tenant.

This lack of *lien de droit* has traditionally left the subtenant in an extremely precarious position. As the courts have held on several occasions,³³ if the head lease is cancelled, terminated or resiliated, the head lease no longer has any effect. The subtenant must relinquish its possession of the premises and the only recourse it may have is to claim damages against the head tenant/sublandlord. Not only is this unsatisfactory to the subtenant who wants to remain in the premises, but may even be illusory if the sublandlord proves to be insolvent.

Most of the examples in the jurisprudence deal with the landlord exercising a right to cancel the lease as a result of the head tenant's default. It has even been suggested that where the head landlord and the head tenant voluntarily agree to terminate the head lease, this would entail the effective termination of the sublease.³⁴ From the subtenant's point of view, this clearly does not yield a very satisfactory result.

(b) CCQ Provisions

Articles 1874, 1875 and 1876 CCQ bring certain innovations to the law regarding subleases, but they may not resolve the fundamental problem of the subtenant who wants to remain in the premises.

Article 1874 CCQ appears to be a carry over of the rule contained in Article 1620 CCLC. Article 1874 CCQ provides that the subtenant cannot be required to pay amounts that are greater than what the subtenant is required to pay under the sublease. Suppose the sublease is either in good standing or alternatively, the subtenant pays all amounts owing to the head tenant, but in either case, the defaults under the head lease are not fully cured. If the landlord seeks to cancel the head lease, would the subtenant still retain any rights to remain in the premises or would the existing jurisprudential position based on no *lien de droit* continue to apply?

³³ See for example: *Prize Realty Corporation v. Friedman et Lemay*, [1972] C.A. 286.

³⁴ *Distributions Claude Guérard Inc. v. Galeries Cousineau Inc.*: S.C.M. 500-05-011409-826.

The legislature may have thought that it was creating some special right in favour of the subtenant, but if it was doing so, certainly Article 1874 CCQ (or for that matter the other articles) do not appear to come to the subtenant's rescue; to argue otherwise would mean that if the subrental is less than the head rental, the head landlord would effectively have to accept the lesser amount. This surely cannot be the intention of the legislature.

Cancellation may not necessarily be in the landlord's best interest, particularly in weak markets where tenants are difficult to find. To maintain cash flow, landlord's leases should provide that a sublease cannot be at rentals which are less than the rentals payable under the head lease. To avoid the situation where the subtenant pays the head tenant but the head tenant does not pay the head landlord, provide in the lease that the subrentals are assigned to the head landlord and that the subtenant pays directly to the head landlord.

Articles 1875 and 1876 CCQ appear to give the head landlord and the subtenant certain rights against one another, despite the fact that there may be no contractual *lien de droit*. Article 1875 CCQ entitles the head landlord to resiliate the sublease where the subtenant is in default and the default is causing the landlord or other lessees or occupants serious prejudice. Article 1876 CCQ permits the subtenant to exercise remedies normally belonging to the tenant where the landlord is not fulfilling its obligations under the head lease. For example, if the landlord is supposed to clear the snow from the parking lot and it is not being done, the subtenant does not have to rely on the head tenant to force the landlord to do so, but would be entitled to force the head landlord to do so directly.

These latter two articles (Articles 1875 and 1876 CCQ) probably would not have been necessary if the law intended to create a direct *lien de droit* between the head landlord and the subtenant, thus further substantiating the argument that the subtenant is still at risk.

The subtenant should protect itself by obtaining an attornment agreement from the landlord entitling the subtenant to continue the lease if the head tenant defaults.

This may create negotiating problems. At the head landlord level, the sublease terms may be less favourable to the head landlord than are the terms of the head lease. At the level of the head tenant and the subtenant such as in franchise and affiliation situations, the head tenant may have a particular interest in what is known as "controlling the real estate" and may not wish to confer an advantage upon the subtenant.

4.5 Recourses of the Parties

4.5.1 CCLC Position

Where the landlord was in default, Article 1610 CCLC entitled the tenant to claim, in addition to damages, specific performance of the obligation in cases which admit of it, cancellation of the contract if inexecution causes the tenant serious prejudice and a reduction of the rent.

Where the tenant was in default, Article 1628 CCLC entitled the landlord to claim, in addition to damages, specific performance of the obligation in cases which admit of it and cancellation of the contract if the inexecution causes him serious prejudice.

Article 1633 CCLC permitted the tenant to avoid cancellation of the lease for non-payment of rent by paying all amounts due prior to judgement. The courts have ruled in the past that a tenant may renounce to this right.³⁵ Although some writers on the subject believed Article 1633 CCLC to be of public order, it is certainly arguable that by making Article 1633 CCLC a provision of public order for residential leases (See Articles 1656.6 and 1664 CCLC) and not so for commercial leases, the legislature implicitly permitted the parties to contract out of Article 1633 CCLC.³⁶

4.5.2 CCQ Rules

Article 1863 CCQ combines the remedies for both landlords and tenants as follows:

"The non-performance of an obligation by one of the parties entitles the other party to apply for, in addition to damages, specific performance of the obligation in cases which admit of it. He may apply for the resiliation of a lease whether or not performance causes serious injury to him or, in the case of the lease of an immovable, to the other occupants.

The non-performance also entitles the lessee to apply for a reduction of rent; where the court grants it, the lessor, upon remedying his default, is entitled to re-establish the rent for the future."

Article 1883 CCQ restates the general notion of Article 1633 CCLC but adds that interest is to be fixed in accordance with Section 28 of *the Act Respecting the Ministère du Revenu*, or at a lower rate agreed upon with the landlord.

On its face, Article 1863 CCQ does not change the existing law. However, how does this fit with the new provisions on obligations which will permit a party to a contract to resiliate the contract without having to take judicial proceedings?

Article 1605 CCQ provides:

*"A contract may be resolved or resiliated **without judicial proceedings** where the debtor is in default by operation of law or where he has failed to perform his obligation within the time allowed in the writing putting him in default." (Emphasis added)*

Articles 1594 and following of the CCQ stipulate how a debtor may be placed in default and Article 1604 CCQ provides that notwithstanding any stipulation to the contrary, a creditor is not entitled to resolution or resiliation of the contract if the default of the debtor is of minor importance, unless, in the case an obligation of successive performance (of which a lease is an example), the default occurs repeatedly.

³⁵ See for example: *Lévy v. Sperdakos*, [1959] C.S. 89.

³⁶ This reasoning was successfully adopted in *Family Life Assurance Company v. Crecco* (supra note 30) in the context of determining whether or not Article 1619 CCLC was of public order.

The policy of the law is to attempt to avoid judicial proceedings and allow parties to deal extra-judicially where a debtor is in "serious default". However, assuming that the default is a serious one or a repeated one (such as continuing failure to operate premises where there exists a continuous operating covenant or a continuing failure to pay the rent), must the landlord take legal proceedings to terminate the lease under Article 1863 CCQ? If it has contracted out of the effects of Article 1883 CCQ, then having taken proceedings, is it obliged to accept the rent and avoid the cancellation or can the landlord simply cancel the lease in accordance with Article 1605 CCQ by written notice to the tenant?

Landlords have unsuccessfully argued that the remedies under Article 1863 CCQ do not override the general rules on obligations. The prevailing view today as expressed by the Quebec Court of Appeal in the case of *Place Fleur de Lys v. Tags Kiosk Ltd.*³⁷ is that a landlord may not unilaterally cancel a lease in default without a judicial declaration to that effect. The same rule has recently been applied to a tenant who, claiming that it was not receiving peaceable enjoyment, attempted to unilaterally cancel its lease.³⁸

This result proved particularly oppressive upon landlords who were forced to wait out the Court process while defaulting tenants continued to operate and not pay any rent.

The Quebec legislature responded by creating a "fast tracking" procedure³⁹ which applies to leases and other specified contracts, and in addition, by permitting disputes between landlords and tenants to be heard by way of motion,⁴⁰ which is even more expeditious than the fast track.

A judicial debate then arose as to whether the claims should be made under the fast track or under the motion. The prevailing view today is that if the claim is purely monetary, such as a claim for rent, the fast track applies,⁴¹ if a interpretation of the lease or an adjudication on a right or obligation, such as a right to cancel, is involved, either procedure is permissible.⁴²

4.5.3 Abolition of the Landlord's Privilege

One of the major changes to the law affecting landlords and tenants is the abolition of the landlord's privilege.

Prior to January 1, 1994, the landlord benefited from a privilege granted by law over the moveable effects found in the premises to secure the tenant's obligations under the lease which belonged to the tenant, belonged to a subtenant to the extent the subtenant owed money to the tenant and belonged to third parties who have not notified the landlord of their rights. Landlords would routinely seize the movable on the premises before judgement as permitted by Article 734(2) of the Code of Civil Procedure.

³⁷ [1995] R.J.Q. 1654.

³⁸ *9005-3083 Quebec Inc. v. Boivin*, J.E. 98-1180.

³⁹ Articles 481.1 to 481.17 of the Code of Civil Procedure ("CCP").

⁴⁰ Article 762 (f) CCP: "*applications relating to rights and obligations arising from a lease*".

⁴¹ *Trizec Place Ville-Marie Inc. v. 2959-6319 Quebec Inc.*, J.E. 97-814.

⁴² *Povitz v. Augusta Craig Canada Ltd.*, J.E. 97-985.

The CCQ abolished the landlord's privilege with respect to leases which are not in force on December 31, 1993. Article 734(2) CCP has also been abolished.

With respect to pre-1994 leases, Article 134(5) of the *Transitional Act* granted the landlord a legal hypothec for a maximum of ten (10) years or the balance of the term, whichever event first occurred expired, provided that by December 31, 1994, the landlord published its rights in the register of personal and movable rights in the manner prescribed by the regulations. Conventional hypothecs now being used by certain institutional lenders contain an obligation on the part of the borrower to ensure that the publication has been made.

All of the foregoing applies equally to sublandlords.

The abolition of the landlord's privilege provides an opportunity to re-visit questions of credit worthiness and security. Alternatives may include a movable hypothec, guarantees, letters of credit and so forth.

4.5.4 The Movable Hypothec

For most landlords of retail, commercial or industrial space, the movable hypothec without delivery on a universality of movables located on the premises from time to time has become an almost automatic form of security. Article 2674 CCQ stipulates that the hypothec will extend to property of the same nature which replaces property alienated in the ordinary course of business of the enterprise. So when a retailer replaces inventory, the new inventory would equally be subject to the change.

The movable hypothec must be in writing (Article 2691 CCQ). The hypothec must contain a sufficient description of the nature of the hypothecated property which, in the case of the universality of movables, is an indication of the universality (Article 2697 CCQ).

The hypothec on a universality of movables is only available where the grantor is carrying on an enterprise. An "enterprise" is defined in Article 1525 CCQ as follows:

"The carrying on by one or more persons of an organized economic activity, whether or not it is commercial in nature, consisting of producing, administering or alienating property or providing a service, constitutes the carrying on of an enterprise."

This definition is probably sufficiently wide to capture most commercial tenancies. However, the landlord must be certain who is operating the enterprise to ensure that the hypothec is obtained from the right person.

If the enterprise subsequently becomes operated by another person (such as, for example, a transferee), the landlord may preserve the hypothec by filing a notice of preservation within fifteen (15) days of the date he becomes aware of or consents to the transfer (Article 2700 CCQ). This procedure should be part of the transfer approval process.

The hypothec will rank from the date of registration (Article 2950 CCQ). For carry-overs under Article 134(5) of the Transitional Act, the legal hypothec will preserve the ranking available under the CCLC.

In bankruptcy, will the movable hypothec be invertible into the landlord's preferred claim or be treated as a secured claim, thereby elevating the landlord to a secured creditor status? In 1997, the Quebec Court of Appeal ruled in the case of *In re: Ocean Drive, Canpro Investments Inc. v. Sam Levy & Associés Inc.*⁴³ that the rules in the federal *Bankruptcy and Insolvency Act* have paramountcy of over security created under the authority of provincial legislation. Therefore, where the tenant goes bankrupt, the federal rules apply and the landlord is relegated to its preferred creditor status.

4.5.5 Guarantees

Landlords and sublandlords alike should review their standard form guarantees to deal with specific problems created by the CCQ.

As was the case under the former law, Article 1881 CCQ perpetuates the principle that the guarantee does not apply to an extended or renewed lease. This does not appear to be of public order and, as in the past, the guarantee should be made applicable to extensions and renewals of leases.

Article 2355 CCQ prohibits a waiver of the right of surety to be subrogated in the rights of the creditor against the principal debtor. In the writer's view, this is of public order and may not be derogated from contractually.

In the case of guarantees given by individuals, Article 2361 CCQ declares that the guarantee ends automatically by the death of the surety. This is of public order and cannot be derogated from contractually.

Article 2362 CCQ entitles the surety to terminate the guarantee of future or indeterminate obligations after three (3) years if the debt has not become exigible, by giving "prior and sufficient notice to the debtor, the creditor and other sureties". How might this apply to lease obligations? Most monetary and non-monetary obligations are created at the outset but are performed over time. Thus the "future" aspect of Article 2362 CCQ probably will not apply in most cases. Certain obligations, such as payment of percentage rent which is calculated on the basis of gross revenue and variable expenses such as a proportionate share of operating expenses and taxes, may be indeterminate debts, as their quantification is a function of future sales or future costs, as the case may be.

If the guarantor agrees to contract out of Article 2362 CCQ, will this be enforceable? Although opinion is divided on the subject, in the writer's view, the facultative drafting of Article 2362 CCQ does not lend itself to being construed as a rule of public order. Contrast this, for example, with Article 2361 CCQ, which stipulates in unequivocal terms that "**notwithstanding any contrary provision**, the death of the surety terminates the suretyship. However, if the guarantee is considered a contract of adhesion and the court considers that a waiver of the right to terminate the suretyship is abusive, the court may declare the waiver null in accordance with Article 1437 CCQ.

⁴³ [1998] R.J.Q. 30.

5. CONCLUSION

The new Civil Code offers a great challenge to all of those involved in the commercial real estate business. Not only has the terminology changed, but basic concepts have changed as well.

The landlord with standard leases, standard offers and similar agreements should review them intensively without delay and redraft them as necessary to comply with the philosophy of the new law and the new rules.