

PROPERTY — LEASING UPDATE

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An Unappealing Proposal: An Obligation to Negotiate in Good Faith?

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Suppose for a moment that in negotiating a lease, the landlord was required to tell a prospective tenant that it had received no offers in the last six months and that the last one it did receive offered rent of \$10 per square foot while the landlord was asking \$30 per square foot. Such a proposition goes against all conceptual notions of negotiation, where hard bargaining rules and each party seeks to get the best deal for themselves. While it has long been recognized that there is an obligation to perform the obligations of a contract in good faith, absent special circumstances such as employer/employee and franchisor/franchisee relationships, no court has suggested that there is a general duty to negotiate in good faith. Courts are cautious about creating rights for which the parties have not bargained. However, recent Ontario Superior Court and Supreme Court of Canada decisions signal that change may be on the horizon.

In *SCM Insurance Services v. Medisys Corporate Health LP*, 2014 ONSC 2632, Cira agreed to waive a restrictive covenant it held against Medisys on the condition that Cira would have the first opportunity to negotiate for the purchase of a business that Medisys was buying. The parties were unable to reach an agreement and Medisys subsequently sold the business to Cira's competitor. Cira sought an injunction preventing the sale on the basis that, among other reasons, Medisys had breached its duty of good faith.

Although there was no express covenant between the parties to negotiate in good faith, the court implied such an obligation as "a necessary corollary" of Cira's waiver of the restrictive covenant. In the court's view, "the parties must have intended that the Medisys obligation to offer the Business to [Cira] would constitute an enforceable obligation". While the scope of this obligation required Medisys to "act reasonably in negotiating a possible sale" it "did not obligate Medisys to agree to whatever price or other terms [Cira] considered reasonable", nor could Medisys adopt "a negotiating position that 'eviscerates or defeats the objectives of the agreement that they have entered into'". The court held that no breach had occurred on the basis that Medisys' position with respect to the terms of the sale was not unreasonable and there was no evidence to suggest that Medisys did not honestly believe their approach to be credible.

The court also found that Medisys' obligation to negotiate in good faith did not give Cira the right to match the offer from Cira's competitor. This was seen as implying a "substantive right" which is "not consistent with the conceptual function of the duty of good faith, which is limited to ensuring the performance and enforcement of the provisions of a contract". So while the court was willing to imply "necessary corollary" obligations, it was unwilling to imply new substantive rights into the agreement.

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Navigating this distinction may prove difficult, although it is important to recall the narrow facts of this case: the court implied a duty to negotiate in good faith based on Cira's waiver of its restrictive covenant which came in the context of an ongoing relationship. In the circumstances, perhaps it is fair that Medisys be required to negotiate the subsequent sale in a fair and reasonable manner.

How might this apply to lease negotiations? Suppose an offer does not state that the parties are required to negotiate the subsequent lease in good faith. Would a court nevertheless find that doing so was implied as a "necessary corollary" of signing the offer? If a landlord insists on retaining a favourable, one-sided indemnity provision, would a court view this position as not being within the realm of reasonable positions and therefore a violation of an implied duty to negotiate in good faith? The facts of each situation will be of paramount importance.

This emphasis on the facts is particularly significant in light of a recent Supreme Court of Canada decision (*Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53) which makes clear that in cases of contractual interpretation (such as leases), deference is owed to the trial judge's decision. Practically speaking, this means that if a judge determines that the facts of a particular situation give rise to a duty to negotiate in good faith, barring a particularly egregious error on the judge's part, this determination is generally not appealable to a higher court. While this has the benefit of providing greater certainty at an earlier stage in the legal proceedings, it will be of little comfort to the party who is found to have not negotiated in good faith and has no avenue to appeal that outcome.

It is too early to say whether the combined effect of these two cases opens the door to a new era of lease negotiations. Only time, and likely a few more court decisions, will tell.

PROPERTY

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