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MEANING OUT OF THIN AIR: HOW COURTS RESOLVE CONTRACTUAL AMBIGUITIES

In a recent Ontario Superior Court of Justice decision, the Court was tasked with determining whether certain costs related to an open-air atrium, a rent free fixturing period, and leasing commissions were all “reasonable” expenses in connection with a sublease transaction. Its decision turned on principles of contract interpretation. Incidentally, the decision also provides a cautionary tale about paying close attention to how sublease space - or in fact any space - is described in an agreement.

The Facts:

In *Pinnacle International Inc (One Yonge) v. Torstar Corporation*, the Landlord and the Tenant had previously entered into a Lease for the entire third floor of a building. According to the Lease, the rentable area of the third floor was 65,534 square-feet, 18,827 of which was an open-air atrium.

The Tenant sublet its premises to a third party. The sublet premises were described as the “entire third floor”. The sublet premises were “deemed” to measure 46,707 square feet. Essentially, the sublet premises excluded the atrium space. The Subtenant was to have a three month rent-free fixturing period.

The transfer provision required the Tenant to pay any profits on a subletting, net of reasonable costs, to the Landlord. The Landlord and Tenant disagreed on whether

there was any profit, and as to what constituted reasonable costs in connection with the sublease.

In calculating profits, the Tenant argued that it should be allowed to deduct the following: **1)** rent paid by the Tenant during the subtenant’s rent-free fixturing period; **2)** rent paid by the Tenant on the atrium space (since, in accordance with the sublease, the subtenant did not pay rent on that space); and **3)** real estate commissions and legal fees incurred to secure the sublease. After deducting these “costs”, the Tenant claimed a net loss of \$2 million.

The Landlord disputed costs **1)** and **2)**, claiming that, actually, the Tenant owed the Landlord \$2 million as profits.

The Ruling:

The Court agreed with the Tenant on costs **1)** and **3)**, and agreed with the Landlord on costs **2)**. It ordered the parties to recalculate the profits in light of those findings.

In coming to its decision, the Court relied on general principles of contract interpretation. It emphasized the significance of enforcing the intentions of the parties by giving the words of the contract their ordinary and plain meaning while adhering to sound business principles and good business sense.

The Interpretation:

Although the sublease stated that it was for the “entire third floor”, the rentable area of the sublet space, for purposes of calculating rent, excluded the square footage of the atrium. The Court concluded that it was commercially absurd for the Tenant, having itself elected to grant a sublease of only the useable space in the premises, to claim the rent payable under the Lease on the unusable space (the “atrium”) as a cost of the sublease transaction and therefore a legitimate deduction from profits. The Court reasoned that it would be commercially non-sensical and inconsistent with the plain wording and purpose of the provisions of the Lease, that effectively served to prohibit the Tenant from profiting on a sublease. In other words, the Tenant’s sublease of less than all of the leased premises did not cause the rent payable on the space that it had not subleased to be a cost of the sublease, and therefore deductible from the sublease revenue earned on the space that had been subleased.

This certainly seems logical. To hold otherwise would be to allow a tenant to

creatively mismatch sublease revenue to portions of the subleased/non-subleased space.

Not surprisingly, the Court found that the Tenant’s costs of the rent-free fixturing period and leasing commissions in connection with the sublease qualified as “reasonable costs”. The Court noted that even the Landlord’s witness admitted that rent-free fixturing periods represented costs commonly incurred in the commercial leasing industry. It also concluded that broker’s commissions were typical costs that the parties would have intended be deductible under the profit provision of the transfer clause.

Takeaways:

In resolving contractual disputes, Courts will seek to enforce the interpretation that most accurately reflects the intentions of the parties. This intention is to be ascertained from the plain and ordinary meaning of the words of the contract. Where inconsistent with reasonable commercial outcomes, overly technical interpretations or those that strain commercial logic, will not be accepted.

ANNOUNCEMENT

Daoust Vukovich LLP is pleased to announce that BRIAN PARKER has been admitted to partnership. Brian joined the firm in 2013 as an articling student and stayed on as an associate lawyer since 2014. Brian’s practice is comprised of all types of commercial leasing, as well as construction contracts and telecommunication access agreements. Brian can be reached at bparker@dv-law.com and at 416-591-3036.

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