COURT OF APPEAL

CANADA
PROVINCE OF QUEBEC
REGISTRY OF MONTREAL

No: 500-09-020027-090
(500-17-018363-039)

DATE: FEBRUARY 25, 2011

CORAM: THE HONOURABLE FRANCE THIBAULT, J.A.
NICHOLAS KASIRER, J.A.
RICHARD WAGNER, J.C.A.

BLEURY-DORCHESTER REALTIES INC.
APPELLANT – defendant/cross-plaintiff
v.

THE UNITED STATES OF AMERICA
RESPONDENT – plaintiff/cross-defendant

JUDGMENT

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[1] The Court is seized of an appeal from a judgment of the Superior Court, District of Montreal (the Honourable Diane Marcelin), rendered on August 25, 2009.

[2] Bleury-Dorchester Realties Inc. is the registered owner and landlord of a commercial building in downtown Montreal. The tenant, the United States of America, operates consular activities in office space pursuant to a lease dated January 25, 1989 for an initial period of fifteen years, ending on December 31, 2003.

[3] Given the costs of adapting the premises for the operation of a consulate, the respondent paid an amount of approximately $2,000,000 as "set-up costs" pursuant to its initial lease. According to joint admission 4.1 filed at trial and forming part of the judgment, these were fully paid by the respondent as of the date for the first extension of the lease. The set-up costs included expenses for a dedicated elevator, internal staircases, a communications vault, hardline partitions and more. The appellant's

expert Grainger calculated this amount, amortized over five years, to be the equivalent of $12.92 per square foot per annum.

[4] Schedule E of the lease agreement provides for tenant options for three lease extension terms of five years, two years and five years respectively. On December 17, 2002, the respondent advised the appellant of its intention to exercise its option to renew the lease for the first extended term.

[5] A dispute arose as to the amount of rent that would be payable pursuant to article 3A of Schedule E of the lease agreement. This clause reads as follows:

> 3A. Provided the Tenant has not been in default in respect of any of the terms and conditions of this Lease during the six-month period immediately prior to the date of exercise of the option referred to herein which has not been cured within the delays provided for herein, and provided the Tenant remains in occupation of all of the Premises throughout the Term hereof, Tenant shall have the option to extend the term of the Lease for all but not less than all of the Premises for a further period of five (5) years ("First Extended Term") upon and under all of the same terms and conditions herein contained save and except that the Premises shall be taken in their then "as is" condition, there shall be no tenant inducement or allowances, the Tenant shall not be obliged to effect the payments referred to in Section 6 or 8 of this Schedule "E", and the rental rate shall be the then current market rental rate as of the commencement of the First Extended Term for similar premises in the Building for leases of similar duration (the whole with reference to such current market rental rate determined as of any given date hereinafter referred to as the "Market Rate"). In the event that the Market Rate is less than the rental paid by the Tenant during the last year of the Term (such rental paid by Tenant during the last year of the Term hereinafter referred to as the "First Standard"), the rental so determined (being the Market Rate as aforementioned) shall be applicable with reference to the first year only of the First Extended Term and the rental rate shall be subject to an annual adjustment in the manner aforementioned until such time as the Market Rate applicable at the time such new determination is made is equal to or greater than the First Standard and upon such event occurring, the rental for the balance of the First Extended Term then remaining shall be based upon the Market Rate at the time such last determination was made.
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> To exercise the foregoing option, Tenant must give written notice thereof to Landlord no later than Twelve (12) months prior to the expiry of the Term, in default whereof said option and any further options shall be deemed null and void and of no further legal effect.

[6] Immediately prior to the first extension, the respondent was paying an amount of $36.03 per square foot as rental. The only other tenant of note in the building at the time of renewal is the parent company of the appellant, SNC-Lavalin.

* * *

[7] The trial judge held that the respondent had properly exercised its renewal option and that the rent payable should be reduced by an amount representing the amortized value of set-up costs paid by the respondent in the initial term of the lease.

[8] The judge was of the view that the premises rented by appellant to SNC-Lavalin constituted "similar premises in the Building for leases of similar duration" within the meaning of that expression in article 3A of Schedule E of the lease. Reviewing the 1986 SNC-Lavalin lease and the 1995 SNC-Lavalin lease that replaced it, she decided that SNC-Lavalin paid $34.51 per square foot in rent at the time of renewal of the respondent's lease. In order to determine the "Market Rate" under the renewal clause, she deducted $12.92 per square foot from the amount of $36.03 paid by the respondents, noting that no set-up costs were required for the respondent for the first renewal option period. Accordingly, she concluded that the base rent should be $23.11 per square foot, plus certain additional amounts provided for in the lease. The amount for storage space should be $25.92.

* * *

[9] Several matters in dispute at trial, including responsibility for insurance premiums, are no longer at issue on appeal. Matters outstanding concern whether the SNC-Lavalin premises are "similar" for the purposes of calculating the market rent and what the amount of the rent payable should be pursuant to article 3A of Schedule E. These may be treated succinctly in turn.

1) Are the SNC-Lavalin premises "similar premises in the building for leases of a similar duration" pursuant the article 3A of Schedule E of the lease agreement?

[10] The appellant contends that the trial judge erred in concluding the SNC-Lavalin premises constituted "similar premises" under article 3A of Schedule E. The respondent had repeatedly taken the position in its proceedings and at trial that the SNC-Lavalin lease was not similar and, says the appellant, this should be considered a binding judicial admission. Moreover, respondent solicited experts' reports as to market rental conditions for premises outside the building in which it was asserted that no comparable market rental rate was available in the subject building. Appellant states the judge was obliged to accept this position. Given that there are no similar premises in the building, says the appellant, the judge was constrained to find the renewal clause to be not applicable.

[11] The appellant's argument on this point is not convincing. The trial judge exercised her discretion as trier of fact in deciding, at paragraph [84] of her reasons, that the SNC-Lavalin premises were "similar" within the meaning of that term in the

lease and the appellant has shown no reason why that decision should be disturbed by the Court. The judge was not bound by the expert's opinion, especially when one in view of the fact that the expert in question did not read the SNC-Lavalin lease and thus was hardly in a position to say the premises of SNC-Lavalin were dissimilar.[1] The statements made by the respondents in its pleadings did not constitute admissions that bound the judge, especially considering that the respondent offered alternative arguments in support of its position depending on whether or not the clause applied. After reviewing the SNC-Lavalin lease, the judge decided that SNC-Lavalin premises were similar to those of the respondent. Indeed, the judge concluded that, on her view of the evidence, the parties intended SNC-Lavalin to be treated as a similar tenant for the purposes of Section 3A: "It is evident that SNC-Lavalin had to be considered a similar tenant from the very beginning in order to give effect to this renewal section" (para. [85]). The appellant shows no error reviewable here.

2) Was the amount of the rent fixed by the trial judge for the extended term justified on the evidence?

[12] The appellant argues that the judge's calculation of the "market rental rate" pursuant to the renewal clause of $23.11 per square foot is erroneous. The judge took the last contracted rent for the five-year period ending December 31, 2003 paid by the respondent ($36.03 per square foot) and subtracted an estimate for the set-up costs referred to in the appellant's expert report prepared by Devencore ($12.92 per square foot). This was a mistake, according to the appellant, in that the parties had admitted that the set-up costs were paid in full by the respondent and never were intended to form part of the rental rate in the initial lease. Pointing to paragraphs [61] and [64] of the judgment, the appellant suggests that the judge confused leasehold improvements, amortized throughout the initial term of the lease, and set-up costs that were not so amortized because they did not form part of the rent.

[13] The judge did not mistakenly amortize the set-up costs already paid by the respondent. Her task, in calculating the "Market Rate" under the renewal clause, was to calculate the comparable rent under the SNC-Lavalin lease as "similar premises in the Building for leases of similar duration." The issue she faced was whether a deduction should be made for the amortized value of set-up costs under the SNC-Lavalin lease, for the purposes of comparison, under article 3A.

[14] The appellant engaged RSM Richter to prepare a detailed analysis of the 1986 and 1995 SNC-Lavalin leases, their numerous addenda and lease adjustment fee. This expert report concluded that the then current rental rate under the 1995 lease was $34.86.[2] The appellant says there was no evidence in the Richter report to suggest that any set-up costs in the SNC-Lavalin lease were amortized in the rent. The judge

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1 A.F., vol. III, p. 861: "Mais j'ai vu le… j'ai pas vraiment vu le bail" (Norman Roy).

2 The trial judge reviewed this calculation and fixed it at $34.51. The appellant suggests this review was mistaken but does not consider the difference material on appeal.

should have applied the SNC-Lavalin rent without a deduction for set-up costs and her failure to do so was an error that commands the Court's intervention on appeal.

[15] Despite able argument of counsel, the appellant has failed to demonstrate that the judge made any such error.

[16] At trial, the representative of RSM Richter explained the manner in which the rent due was calculated under the SNC-Lavalin lease. He said he did not consider whether the rent included an amount for leasehold improvements or tenant inducements amortized over time. When asked whether he inquired about whether such amounts were amortized over the years, he answered: "I did not go and dig into, analyze or trying *(sic)* to figure out what was going on with how they arrived at the numbers they did in the '86 lease. [...] I did not look – no, I did not look at that at all".[3]

[17] The judge undertook an analysis of both the 1986 SNC-Lavalin lease – between arm's-length parties – and the 1995 SNC-Lavalin lease, between the appellant, as landlord, and its parent company, as tenant. She observed the payment, in the second lease, of a lease adjustment fee paid by the parent company to its subsidiary. The expert RSM Richter said this was undertaken for tax purposes, and meant that the effective rent paid under the second lease was the same as the first.

[18] The judge wrote at paragraph [76] "[t]he rent in 2004 [paid by SNC-Lavalin], which is the year of the First Extended Period for the USA, utilising the square feet actually leased in the second SNC lease comes to $34.51 per square foot including the amortization of the tenant set-up costs since the original term only ended at the end of 2008 [emphasis added]."

[19] Appellant contends that the judge's decision that the rent paid by SNC-Lavalin included amortized set-up costs had no basis in the evidence presented at trial.

[20] The Court disagrees.

[21] Once the judge decided the SNC-Lavalin lease was the comparator pursuant to Schedule E, she undertook an analysis of the relevant documents, including the two SNC-Lavalin leases, taken together, in order to ascertain the intention of the parties (para. [82]). Based on her understanding of that intention, she decided that the set-up costs had been amortized in the SNC-Lavalin rent.

[22] In support of the judge's conclusion, the respondent pointed to the definitions in paragraph A in Schedule E of the 1986 SNC-Lavalin lease in which "Base Building Work" was to be undertaken by the landlord at its expense, distinct from scheduled work to be undertaken at the tenant's expense, prior to the commencement of the lease. In addition, the respondent argued that article 2 ("extension options") and article 4 ("tenant

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[3] A.F., vol. V, 1169-1170 (Mr Andrew Michelin).

allowances") of the renewal clause in Schedule I of the 1986 lease confirm the position taken by the judge that the tenant allowances in the SNC-Lavalin lease should be deducted from the rent as amortized costs. While these texts are not free from ambiguity, they do provide a reasonable basis for the judge's interpretation that tenant set-up costs in the comparator lease were amortized in the rent payable by SNC-Lavalin at the time of the respondent's renewal.

[23] Given that there are no set-up costs in the respondent's renewal option, the judge decided that it would be unfair for the cost of such amounts to be included in the base rent of respondent. As a result, she decided that an amount equivalent to the value of the initial set-up costs paid for when the respondent moved in should be deducted from the base rent (paras. [86] and [87]).

[24] To conclude on this point, the appellant has not shown the presence of an error by the judge that justifies the intervention of the Court.

[25] It bears noting that her decision to deduct $12.92 as the equivalent of set-up costs has the additional virtue, from the point of view of the equities of the matter, of aligning the "Market Rate" under Schedule E with experts' estimates of market rate elsewhere in the downtown core, as appears in particular from the appellant's expert report. While this does not justify the outcome in itself, it provides additional comfort on appeal, especially given the fact the SNC-Lavalin lease referred to similar buildings in its distinct renewal clause.

FOR THESE REASONS, THE COURT:

[26] **DISMISSES** the appeal, with costs.

FRANCE THIBAULT, J.A.

NICHOLAS KASIRER, J.A.

RICHARD WAGNER, J.C.A.

Mtre Albert Greenspoon
KAUFMAN, LARAMÉE
For the appellant

Mtre Jack Greenstein
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Date of hearing: February 21, 2011