IN THE MATTER OF AN ARBITRATION

B E T W E E N:

[redacted] **CANADA LIMITED**

Claimant

- and -

[redacted] **ONTARIO INC.**

Respondent

DECISION

DATE OF HEARING: January 18, 19, 20, 2017

PLACE OF HEARING: Toronto, Ontario

DATE OF DECISION: January 31, 2017

APPEARANCES:

For the Claimants: [redacted]

Counsel: [redacted]

For the Respondents: [redacted]

Counsel: [redacted]

Arbitrator: Allan J. Stitt, ADR Chambers

THE PARTIES

The Claimant, [redacted] Canada Limited ("[redacted]"), distributes [redacted] and other products.

The Respondent, [redacted] Ontario Inc. (the "[redacted]"), is a [redacted] and [redacted] company. The [redacted] was represented throughout the term of the Lease Agreement (as defined below) by [redacted] ("[redacted]") and with respect to financial aspects of the Lease Agreement, by [redacted] ("[redacted]").

THE HEARING

An oral hearing was held January 18 to 20, 2017. Each side presented an opening statement, witnesses who were examined in-chief and cross-examined, and a closing statement. [redacted] called Mr. [redacted], Manager of [redacted] for [redacted], Mr. [redacted], [redacted] for [redacted], and Ms. [redacted], principal of [redacted], Inc., a company retained by [redacted] to provide lease administration and auditing services.

The [redacted] called Mr. [redacted], [redacted], and Mr. [redacted], [redacted].

THE ISSUE

The issues I am asked to decide are as follows:

1. Is [redacted] entitled to a refund on amounts paid for utilities in relation to the space it rented ("Leased Premises") in the property at [redacted] (the "Property") for the fiscal years 2013, 2014 and 2015? If it is entitled to a refund, what is the amount of the refund?
2. Is [redacted] entitled to have its fees for its audit refunded and, if so, what is the amount of the refund?
3. Is [redacted] entitled to a refund because amounts charged as expenses should properly have been capital costs amortized over a period of more than one year?
4. What rate of interest should be charged on amounts agreed to be owing and found to be owing to [redacted] from the [redacted]?
5. Should legal fees be reimbursed to either party and, if so, what should be the quantum of fees reimbursed?

There were other issues on which agreement was reached during the course of the hearing.

JURISDICTION

Section 12.2 of the Lease Agreement contains an arbitration clause that states that all disputes arising out of or in connection with the Lease Agreement shall be resolved by arbitration administered by ADR Chambers Inc. in accordance with its arbitration rules. The parties have agreed that I will be the sole arbitrator to determine the issues set out above.

THE FACTS

The bulk of the facts were not in dispute and many of the undisputed facts were set out in the Agreed Statement of Facts. I have attempted to note below where facts were in dispute. As I mentioned at the hearing, I do not think it is worthwhile for me to set out all of the facts but some of the pertinent facts are as follows:

The Agreements

In June, 2010, the [redacted] purchased the [redacted] from [redacted] pursuant to an Agreement of Purchase and Sale ("APS") and the [redacted] agreed to lease the Leased Premises back to [redacted] for a five-year period.

As contemplated in the APS, a Facilities Agreement was entered into between the parties on or about July 9, 2010. Schedule 2.5 of the Facilities Agreement states, in part:

> 6. Consumption of electricity, natural gas and water.
>
> Buyer is billed for total site usage, allocates costs on a (sic) actual amount used by each tenant including [redacted].
>
> Seller to install meters for Leaseback Premises (and may use new, less expensive "check meters" rather than usual meters).

On November 30, 2010, [redacted] and the [redacted] entered into the lease agreement as was contemplated in June when the APS was signed (the "Lease Agreement").

On May 6, 2011 and March 6, 2012, the parties agreed to *addenda* to the Lease Agreement. Both *addenda* reference the Facilities Agreement and define it as the agreement entered into on or about July 9, 2010.

[redacted] was required to pay rent to the [redacted] and among other things, was required to pay operating costs including utilities. Section 2.3 of the Lease Agreement sets out how the [redacted] was to determine the utilities costs owed by [redacted]. It says, in part:

> (1)… In this Lease, subject to 1.1(2) below, the Tenant's Share of Operating costs (which include utilities) means:
>
> (a) in the case of an item that is measured or metered (*such as, without limitation, utilities*) [emphasis added] used for, serves and is applicable to only the Leased Premises, 100% of the cost of such item;
>
> …
>
> (c) in the case of an item that is used in, or applicable in part for, the Other Premises and in part for the Leased Premises… means a fraction (expressed as a percentage), the numerator which is the Rentable Area of the Leased Premises and the denominator of which is the Rentable Area of both the Leased Premises and the Other Premises. The Parties agree that such percentage is as of the date of this Lease… 29.995%.
>
> (2) **Equitable Adjustment.** Despite Section 1.1(1)(c) above, the Landlord shall have the right to adjust from time to time, acting reasonably and after consultation with the Tenant, the allocation of the Tenant's Share of Operating Costs determined as set out above in Section 1.1(1)(c) above where it would be equitable and appropriate to do so having regard to the relative use or benefit of any particular item of Operating Costs as between the Leased Premises and the Other Premises.

Section 12.3 of the Lease Agreement contains an Entire Agreement clause that excludes other agreements "except those that are set out in the Lease and the Agreement of Purchase and Sale".

Section 5.5(3) of the Lease Agreement references the Facilities Agreement.

The Process

The process by which [redacted] was to pay its share of operating costs to the [redacted] was that the [redacted] would send [redacted] a budget at the beginning of each year, estimating the operating costs for the year (based mostly on the prior year's costs) for the Leased Premises, and [redacted] would pay the amounts in the budget. At the end of the year, the [redacted] would provide a reconciliation and refund any overpayment made on account of the operating costs.

Occupation of the Leased Premises

During the 2011 and 2012 fiscal years, [redacted] carried on manufacturing at the Leased Premises. During March 2011, there were discussions between representatives of [redacted] and the [redacted] about the [redacted] charging more for utilities than [redacted] *pro rata* share of those expenses for the Property.

All manufacturing ceased in November 2012 and no manufacturing occurred during the three fiscal years for which the dispute exists about utilities charges. From about March 2013 to about August 2015, [redacted] sublet part of the Leased Premises to [redacted] ("[redacted]") which used the space for warehousing. [redacted] stored insulation and kept its rented space very full. The space remained vacant from August 31, 2015 to November 30, 2015.

There was only one [redacted] employee who worked on the site.

After [redacted] ceased manufacturing, it continued to use some of the Leased Premises on the second floor to store office furniture and do periodic mock-ups for customers. It also allowed one of its distribution partners to use some of the space.

In 2013, [redacted] occupied either 36.93% or 39.49%[1] of the Property and paid 79.81% of the cost of the utilities used for the property, or $421,613. [redacted] argues that it should only pay 36.93% of the $528,264 total and asks for a refund of $226,525. The [redacted] has admitted that $54,666 of that amount is properly owing to [redacted].

In 2014, [redacted] occupied 29.64% of the Property and paid 44% of the utilities for the Property or $254,987. [redacted] argues that it should only pay 29.64% of $579,558 and asks for a refund of $83,206.

In 2015, [redacted] occupied 29.64% of the Property and paid 35.57% of the utilities for the Property or $205,277. [redacted] argues that it should only pay 29.64% of $577,170 and asks for a refund of $34,204.

Nov. 3 Call

There was a crucial telephone conference call that took place on November 3, 2014 in which Mr. [redacted] represented [redacted] and a number of representatives of the [redacted] (including Mr. [redacted]) participated. During the call, the method of calculating utilities was discussed, but the witnesses differed on their recollection of what was discussed during the call.

[1] The dispute about square footage of the Leased Premises in 2013 was an issue that arose in the middle of the arbitration, and will be addressed later in these reasons.

Mr. [redacted] testified that Mr. [redacted] advised that, for 2014 and 2015, the [redacted] would be charging for utilities on a *pro rata* basis. Mr. [redacted] also testified that he asked Mr. [redacted] to review whether the [redacted] would also charge on a pro rata basis for the 2013 year and Mr. [redacted] said that he would get back to Mr. [redacted] on that issue.

Mr. [redacted] did not recall committing to charge utilities on a *pro rata* basis for 2014 and 2015. His recollection was that he was going to explore whether that was going to be the approach taken by the [redacted].

I accept the evidence of Mr. [redacted] and where the evidence of Mr. [redacted] and Mr. [redacted] contradict each other, I prefer the evidence of Mr. [redacted]. I am not suggesting that Mr. [redacted] is not telling the truth; on the contrary, I think he was stating his recollection. I prefer the evidence of Mr. [redacted], however, because I believe that the exchange of emails that followed the conference call was more consistent with Mr. [redacted] recollection of the discussion than with Mr. [redacted] recollection.

Subsequent Communication

Mr. [redacted] sent numerous emails to Mr. [redacted] asking Mr. [redacted] to inform [redacted] of its decision with respect to whether to charge [redacted] for utilities or on a *pro rata* basis for the 2013 fiscal year. Mr. [redacted] did not respond to the emails.

In early 2015, the [redacted] presented the 2015 budget and it did not charge utilities on a *pro rata* basis. [redacted] did not bring this fact to the [redacted] attention.

The parties did exchange correspondence in 2015 and 2016 about the dispute and [redacted] continued to reiterate its understanding that utilities would be charged on a *pro rata* basis.

ANALYSIS

Contractual Interpretation

The rules for contractual interpretation were not argued before me, but the law has now been clearly established by the Supreme Court of Canada in, among other cases, *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53. The interpretation of a written contract "must always be grounded in the text and read in light of the entire contract" (*Creston Moly, supra* at para. 57). Also, the "interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine the intent of the parties…." (*Creston Moly, supra* at paras. 46-47).

1. Utilities

Given that the Facilities Agreement was referred to in the Lease Agreement and contemplated in the APS, I believe that I must consider it to determine the intent of the parties.

It was clearly contemplated in the Facilities Agreement that [redacted] would install meters that would measure its actual utilities use and that it would be charged based on actual use. Further, s. 2.3(1)(a) of the Lease Agreement, the section that refers to costs that are measurable for [redacted], specifically refers to utilities as its example. I therefore find that the parties intended that [redacted] pay for the cost of the utilities it actually used, rather than its pro rata share of utilities.

Unfortunately, the meters were never installed so there was no way to measure the utilities actually used by [redacted]. But [redacted] was the party that had the obligation to install the meters and it should not benefit from its failure to install the meters. The mechanism in the Lease Agreement that allows the [redacted] to charge utilities on actual usage when there are no meters is s. 2.3(2) (the equitable adjustment section). I find that it is appropriate to read s. 2.3 broadly, to give effect to the intent of the parties that utilities be billed on the basis of [redacted] actual use. That said, s. 2.3(2) does impose conditions on the Landlord if it wants to avail itself of the section and do an equitable adjustment, and those conditions must be met.

I will now examine these conditions in turn.

First, the [redacted] must consult with [redacted]. While consultation is necessary, agreement is not, and the landlord therefore need only inform [redacted] of its intention to charge based on actual usage rather than *pro rata*.

The [redacted] did so in 2011. It consulted with [redacted] and made [redacted] aware that it was charging on an actual use basis and not a *pro rata* basis. [redacted] argues that while such consultation may have occurred in 2011, the consultation was only in relation to the inequity of charging [redacted] on a *pro rata* basis because [redacted] was engaged in manufacturing. When [redacted] ceased to manufacture in 2013, [redacted] argued, there was a need for further consultation if the [redacted] wished to avail itself of the equitable adjustment clause. I disagree. The parties indicated in the Facilities Agreement an intent that [redacted] pay for its actual usage and the requirement to consult to effect that result should not be an onerous requirement. I believe that the consultation in 2011 was sufficient to indicate that the [redacted] intended to charge on a usage rather than *pro rata* basis until [redacted] was informed otherwise.

There was then a further consultation on November 3, 2014. As stated above, I find that during that call, the [redacted] informed [redacted] that, for 2014 and 2015, it would charge on a *pro rata* rather than actual usage basis.

I find that there were no other consultations that satisfied the consultation requirements in the equitable adjustment clause.

The [redacted] argued that the sending of the budget in 2015 should be considered further consultation. I disagree. That is an obligation under the Lease Agreement and if that were sufficient consultation, there would be no reason to require consultation in s. 2.3(2) as there was already a requirement to send the budget. But there is a requirement for consultation and although I have found that the requirement to consult is not an onerous one, it is a requirement that requires something in addition to the [redacted] other obligations under the Lease Agreement (such as providing a budget).

The [redacted] also argued that Mr. [redacted] did not have the actual authority to inform [redacted] that it was changing its method of calculating utilities charges. Whether Mr. [redacted] did or did not have actual authority, Mr. [redacted] believed Mr. [redacted] had authority. Mr. [redacted] testified that he never informed anyone at [redacted] that he did not have the requisite authority, so I find that Mr. [redacted] had the necessary ostensible authority.

The [redacted] also argued that [redacted] should have challenged the allocation when it received the budget in 2015. I disagree. Both Mr. [redacted] and Ms. [redacted] testified that they believed that the proper time to challenge an allocation was at the time the reconciliation was received, not when the budget was received. I accept that evidence. Further, there is no requirement for [redacted] to dispute amounts that are in the budget and, if they don't dispute those amounts, be required to agree to them. The budgeted amounts were always reduced when the reconciliation arrived and it was reasonable for [redacted] to wait until it received the reconciliation before challenging the amounts requested in the budget (and paid).

Second, the allocation must be equitable and appropriate relative to the other tenants' use of utilities. I am persuaded by the evidence of Mr. [redacted] and Mr. [redacted] that the method of allocation used by the [redacted] was equitable and appropriate based on the other tenants' use of utilities. [redacted] argued that there was no evidence presented by the [redacted] as to the actual use by other tenants. While that is true, there was evidence that approximately 30% of the space was vacant so that the allocation to [redacted] based on actual use would likely be higher than its *pro rata* share of utilities.

In order to calculate the utilities used by [redacted], the [redacted] used the [redacted] Report. The [redacted] Report had been commissioned by [redacted] in the year 2000. It allowed the user to determine the utilities use for various pieces of equipment on the Leased Premises.

After the [redacted] became aware of the dispute that is the subject matter of this arbitration, Mr. [redacted] worked with Mr. [redacted] to re-calculate the utilities actually used by [redacted] in 2013-2015. Mr. [redacted] and Mr. [redacted], in their oral testimonies, set out the process used by the [redacted] to calculate use. It included counting lighting fixtures and units such as HVAC, and applying the process set out in the [redacted] Report. Some adjustments were made to the amount owing by [redacted] as a result of the re-calculation and further adjustments were agreed to as a result of evidence produced during the hearing.

While it would have been preferable to use meters to determine actual utilities consumption, there were no meters because [redacted] failed to install them. I find that the [redacted] process of determining actual use of utilities was one that was equitable and appropriate, subject to my comments when calculating damages.

Third, the [redacted] must be acting reasonably. That suggests that it must make reasonable efforts to determine actual usage if it wants to benefit from the equitable adjustment clause. As stated above, the evidence of Mr. [redacted] and Mr. [redacted] was that the [redacted] did attempt to perform an objective analysis of actual usage. I conclude that the process they used was reasonable, subject to the adjustments I have ordered below.

Fourth, the adjustment can be done "from time to time". If the [redacted] chooses, it may change its approach or adjustment during the lease. As stated above, the 2011 consultation was sufficient until there was a further consultation on the issue. The [redacted] consulted with [redacted] in November of 2014 and indicated that it was going to charge utilities for 2014 and 2015 on a *pro rata* basis. As stated earlier, I find that there was no further consultation as required by s. 2.3(2) of the Lease Agreement after November 2014.

Based on the above analysis, I find that the [redacted] met the conditions for s. 2.3 (2) with respect to 2013 to charge on an actual usage basis but did not meet the conditions for 2014 and 2015.

I should note that the parties had a disagreement about the square footage used by [redacted] in 2013 (and whether it was 39.49% as was set out in the Agreed Statement of Facts or 36.93% as suggested by [redacted]). Because of the conclusion I have reached for 2013, I do not find it necessary to decide the square footage in the Leased Premises for 2013.

2. Audit Fees

I accept the arguments of the [redacted] that no audit was conducted for which audit fees should be reimbursed pursuant to s. 2.5 of the Lease Agreement. The amount requested relates to an error made by the [redacted] in the calculation of management fees (as there were no audit fees claimed in respect of the dispute about utilities). The work that was done to determine that there was an overcharge of management fees consisted of reviewing the Lease Agreement and calculating the maximum fees allowable under the Lease Agreement. In my view, that is not the type of audit envisioned by the parties in s. 2.5 of the Lease Agreement for which audit fees would be recovered. The [redacted] is therefore not obligated to pay [redacted] its costs for the audit fees to determine that the management fee was greater than that allowed under the Lease Agreement.

3. Capital Costs

This claim was abandoned by the Claimant at the hearing.

DAMAGES

I must therefore now determine the amount of the refund to be paid to [redacted] by the [redacted] for the three years, based on the conclusions I have reached.

The [redacted] submitted a chart to me detailing the $191,700 that the [redacted] agreed was owing to [redacted] I order that amount to be repaid to [redacted].

For 2013, [redacted] argues that if the calculation is done on actual usage, [redacted] should receive an additional refund of $28,940 to reflect that lights were on for 16 hours per day, rather than the 22 hours per day assumed by the [redacted]. I find that the evidence supports this adjustment and I am persuaded by the evidence that the [redacted] calculation of actual usage erred in this regard so I order that this amount be returned to [redacted].

[redacted] also argues that, if the calculation is done on actual usage, [redacted] should receive an additional $24,222 as a result of the fact that [redacted] only had one worker in the building, so the calculations should be based on a nine-hour day rather than a 13-hour day. I find that the evidence supports this adjustment as well and I am persuaded by the evidence that the [redacted] calculation of actual usage erred in this regard so I order that this amount also be returned to [redacted].

For 2014, the total utilities used for the Property were $579,558 and [redacted] occupied 29.64% of the Property. The appropriate utilities charge should therefore have been $171,781. [redacted] was charged $254,987. [redacted] is therefore entitled to a refund of $83,206.

For 2015, the total utilities used for the Property were $577,170 and [redacted] occupied 29.64% of the Property. The appropriate utilities charge should therefore have been $171,073. [redacted] was charged $205,277. [redacted] is therefore entitled to a refund of $34,204.

The total amount owing by the [redacted] to [redacted] is therefore $362,272.

I have rounded to the nearest dollar in each case. HST must also be applied to all amounts where HST was paid by [redacted] when it paid its budgeted amounts in advance.

4. Interest

I find that interest is owing on amounts agreed to be repaid and amounts required by this decision to be repaid, at the rate set out by the *Courts of Justice Act*. [redacted] argued that the appropriate rate was the rate set out in the Lease Agreement for late rent payments, but there is nothing in the Lease Agreement to suggest that the parties intended this higher rate of interest to apply to any other obligations.

5. Costs

I invite the parties to make written submissions to me about costs if they cannot agree. Submissions should be provided to me and to the other side by 5 pm on February 10, 2017.

I thank counsel for their skilled and helpful presentations of their clients' cases.

Toronto, Ontario, January 31, 2017

Allan J. Stitt
Arbitrator