



Positive real covenant enforceable as a contractual obligation?

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Parcels of land (including air space parcels) that are dependent upon other parcels of land for their full use and enjoyment raise interesting and complicated issues for the law to resolve and the appraisal profession to value. This point is illustrated in the Supreme Court of Canada decision in *Owners, Strata Plan LMS 3905 v. Crystal Square Parking Corp.*, 2020 SCC 29 [*Crystal Square*].

Seven air space parcels were developed within the Crystal Square development located in Burnaby, British Columbia: 1) retail complex, 2) office tower, 3) residential tower, 4) hotel, 5) parking facility, 6) police office, and 7) cultural centre. The litigants in *Crystal Square* were the strata corporation for the owners of the office tower air space parcel and owner of the parking facility air space parcel.

In the development phase, a required step was the execution of an *Air Space Parcel Agreement (ASP Agreement)* between the developer and the City of Burnaby. Among other things, the *ASP Agreement* provided mutual easements for support, service connections, and vehicular access. The *ASP Agreement* was registered as an easement in the Land Title Office on March 17, 1999.

A section of the *ASP Agreement* required the owner of the parking facility to provide parking and vehicular access to the owners of other air space parcels in exchange for payment of an annual fee. Parking spaces were allocated to the owners of the office tower air space parcel. The *ASP Agreement* also provided that, upon deposit of a strata plan for an air space parcel, the resulting strata corporation would be responsible for payment of the annual parking fee. The *ASP Agreement* further provided that, upon deposit of a strata plan, the strata corporation would enter into an assumption agreement with the owners of the other air space parcels, thereby assuming the obligations under the *ASP Agreement*.

On May 26, 1999, a strata plan for the office tower air space parcel was deposited in the Land Title Office, but the strata corporation never entered into the assumption agreement with the other air space parcel owners. On June 28, 2002, the developer sold the parking facility air space parcel to a parking lot operator. In the transaction, the developer assigned the *ASP Agreement* to the parking facility owner.

Until 2012, the office tower strata members parked in the parking facility and paid the fees set out in the *ASP Agreement*. However, a dispute arose and the strata corporation stopped paying the parking fees. The parking facility owner retaliated by revoking parking privileges. In the resulting litigation, the strata corporation sought, among other things, a declaration that the *ASP Agreement* provision relating to payment was null and void or that it was unenforceable. The strata corporation argued, among other things that the payment provision in the *ASP Agreement* was a positive covenant and, therefore, not enforceable.

The relief sought by the strata corporation required consideration of the law related to covenants running with the land and, since the strata corporation did not exist when the *ASP Agreement* was created, it was also necessary for the Supreme Court of Canada to consider the law related to pre- and post-incorporation contracts.

Positive covenants v. contractual obligations

In *Westbank Holdings Ltd. v. Westgate Shopping Centre Ltd.*, 2001 BCCA 268 [*Westbank*] at para. 16, the British Columbia Court of Appeal described the conditions necessary for a covenant to run with the land:

[16] The necessary conditions of covenants which run with land are set out by DeCasteri in his text, *Registration of Title to Land* (Carswell 1987). They were stated by Clearwater, J. in *Canada Safeway Ltd. v. Thompson (City)*, [1996] M.J. No. 393, August 15, 1996, at page 8, as follows:



- (a) The covenant must be negative in substance and constitute a burden on the covenantor’s land analogous to an easement. No personal or affirmative covenant requiring the expenditure of money or the doing of some act can, apart from statute, be made to run with the land.
- (b) The covenant must be one that touches and concerns the land, i.e., it must be imposed for the benefit or to enhance the value of the benefited land. Further, that land must be capable of being benefited by the covenant at the time it is imposed.
- (c) The benefited as well as the burdened land must be defined with precision the instrument creating the restrictive covenant.
- (d) The conveyance or agreement should state the covenant is imposed on the covenantor’s land for the protection of specified land of the covenantee.
- (e) Unless the contrary is authorized by statute, the titles to both the benefited land and the burdened land are required to be registered.
- (f) Apart from statute, the covenantee must be a person other than the covenantor.¹

Crystal Square confirms the common law prohibition against affirmative (i.e., positive) covenants described in *Westbank*. If the payment provision of the *ASP Agreement* could not be enforced because it was a positive covenant, could the strata corporation be obliged to make payment for parking on the basis

of a post-incorporation contract? The strata corporation resisted this result, arguing that there is no difference between enforcing a post-incorporation contract against it that imposes an obligation of performance related to the land and enforcing the burden of a positive covenant against it as if it ran with the land, and, in any event, the evidence did not support the existence of such a contract.

The Supreme Court of Canada’s response to the strata corporation’s first position was that it ignored the distinction between contract law and property law. The court held that a party’s assumption of a contractual obligation through a post-incorporation contract – for example, an obligation to pay parking fees – is a distinctly different vehicle than a covenant running with the land that binds the covenantor and subsequent owners by virtual of the covenant running with the land.

Pre- and post-incorporation contracts

Having decided that a contract affecting an interest in land did not offend the law pertaining to positive covenants, the Supreme Court of Canada in *Crystal Square* then considered if, in the circumstances of the case, a contract existed obliging the strata corporation to pay the parking fees. As noted earlier, the strata corporation did not exist when the *ASP Agreement* was created. Consequently, the law related to pre- and post-incorporation contracts had to be reviewed and applied.

Writing for the majority of the court, Mr. Justice Cote explained that an agreement entered prior to incorporation (in this case the *ASP Agreement* before the strata corporation was formed) is not binding on the corporation once it comes into existence. However, once created, a corporation can enter into a post-incorporation contract on the same terms as the pre-incorporation contract. Mr. Justice Cote observed that it is also possible under business corporations legislation for a pre-incorporation contract to be adopted by actions or conduct signifying an intention to be bound by the contract.

The difficulty in *Crystal Square* was that strata legislation in British Columbia precluded reliance upon the business corporations legislation, and so it could not be said that the *ASP Agreement* was adopted by the strata corporation. However, depending upon the court's view of the evidence, there was the possibility that the strata corporation by its conduct and actions entered into a post-incorporation contract having the same terms as the *ASP Agreement* that would bind the strata corporation at common law.

Mr. Justice Cote wrote at paragraph 33, "in sum, an 'outward manifestation of assent by each party such as to induce a reasonable expectation in the other' is required in order to find that a binding post-incorporation contract exists ... The test is objective. It requires an examination of how each party's conduct would appear to a reasonable person in the position of the other party ... Thus, a court should determine whether a reasonable person in the position of one party would consider that the other party's conduct constituted an offer ... And conversely, whether a reasonable person in the position of the latter would consider that the former's conduct constituted an acceptance ... The pre-incorporation contract is merely one aspect of the objective circumstances that can be used to interpret the parties' conduct and from which the terms of a post-incorporation contract can be inferred."

At paragraph 37, the learned judge wrote, "To conclude, the applicable test for finding that a post-incorporation contract exists is the same as the one for finding that any other agreement exists at common law. The test is objective, and the offer, acceptance, consideration and terms may be inferred from the parties' conduct and from the surrounding circumstances."

After explaining why a strata corporation has the legal capacity to enter into a post-incorporation contract, Mr. Justice Cote then addressed whether such a contract had been formed in *Crystal Square*. Beginning at paragraph 49, Cote J. referred to the evidence that led the majority of the court to conclude that a post-incorporation contract had been formed. The parking facility owner manifested its intention to offer a contract on the terms of the *ASP Agreement* by making valid parking passes available to the strata corporation members in a quantity that corresponded to the *ASP Agreement*. The court found that the strata members

ought to have known that valuable consideration was being rendered for their benefit (i.e., maintenance and operation of the parking facility) with the expectation the members would pay for the benefit. The strata corporation manifested its intention to accept the parking facility owner's offer by paying the fees contemplated in the *ASP Agreement* and its members exercised the rights corresponding to those payments after the parking facility owner acquired the air space parcel. On this basis, the court concluded that a reasonable person in the parking facility owner's position would see the strata corporation's conduct as assenting to the *ASP Agreement*.

In the course of his reasons for judgment, Mr. Justice Cote emphasized that it is not the subjective intentions of a party that determine if a contract arises. At paragraph 31, he wrote "... This general rule means that 'a subjective mutual consensus is neither necessary nor sufficient for the creation of an enforceable contract' and that 'a person may be bound by contractual obligations that she did not intend (subjectively) to assume'..."

Closing

There are at least three takeaways from *Crystal Square*:

- it remains the law that, save for a statutory exception, positive covenants will not run with the land;
- however, a contractual right that affects land distinct from a property right will be enforceable even if it imposes performance obligations on a landowner; and
- apart from business corporations legislation allowing adoption of pre-incorporation contracts, the general contract principles of offer, acceptance and consideration will be applied to parties' conduct to determine if, objectively speaking, there is an intention to create legally binding relations.

Consequently, apart from the difficulty predicting when a court will determine that a covenant is a positive covenant², it may now be possible in a given set of facts to impose an obligation of performance by arguing that a contractual obligation has arisen by reason of the conduct of the parties. How might this factor into a valuation of property?

End notes

¹ *Covenants Running with the Land*, Canadian Property Valuation, 2014 – Volume 58 – Book 3

² In British Columbia, section 219(1) of the *Land Title Act*, RSBC 1996, c. 250, provides a statutory exception to the common law but that exception is not available as between two private entities.

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