



RealEstateBrief

Fall 2006

In This Issue

	page
Five Questionable Things You May See in a Lease (and Why You Probably Don't Want to Agree to Them)	1
Landlord's Remedies – Application of the Oppression Remedy against Corporate Affiliates of a Defaulting Tenant	4
Implications of B.C.'s New Parking Tax	6
Events	8

In our first article, Celia Hitch reviews the issues arising from five provisions that are sometimes negotiated into commercial leases. Celia also provides some suggestions on how to avoid potential problems. John Contini then reviews the case of *J.S.M. Corporation (Ontario) Ltd. v. The Brick Furniture Warehouse Ltd.*, where the Landlord successfully pursued a claim against a subtenant using the oppression remedy under a *Business Corporations Act*. Finally, Shanah Ali looks at the implications of British Columbia's new parking tax.

Five Questionable Things You May See in a Lease (and Why You Probably Don't Want to Agree to Them)

Introduction

Although most leases are written by competent professionals with deep experience in their area, from time to time, a provision may end up in a lease which creates absurd or unintended results. This is a short list of five areas where you may encounter one of these occasionally questionable results. You may, no doubt, have already formed a similar list of your own.

1. An Exclusive Use Covenant Which is Absolute in its Nature

When I used to work in-house, we had a situation which would show up in my office in June every year. We had one tenant with the exclusive right in a shopping centre to sell Mexican food and one tenant with a broad and general fast food use which included the right to have short-term promotions related to foods which were not part of its core, year-round menu.

Every year, like clockwork, on June 1st, the fajita war would start. The broad and general fast food tenant would introduce fajitas. Because the fajitas were promotional, lots of glossy signs with six-foot high, mouth-watering fajitas would go up. The Mexican food purveyor would see the signs and call the property manager to point out that it had the exclusive right to sell Mexican food. The property manager would call me and tell me to take care of it. I would write the "offending" tenant a letter, telling them to stop selling the fajitas and, every year, on July 2nd, the "offending" tenant would send me a letter confirming that they had stopped selling fajitas.

With some baroque music, it could have passed for a minuet!

What could have been done at the beginning to avoid this at the end? The Mexican tenant's exclusive use clause could have given them protection against any other tenant whose **principal** use was the sale of Mexican food. After all, the fajitas were really exactly what their seller alleged they were – a short-term promotion intended to attract people into their premises so that they could sell more glasses of pop and cartons of french fries – not, in fact, a particularly meaningful attempt to start up a competing business as a Mexican food retailer.

The lesson for landlords is to focus clearly on what is the principal use

and what is ancillary before creating an exclusive rights clause, lest you too find yourself in a fajita war!

2. An Exclusive Use Covenant Which is Not Tied to Occupation of the Premises

For reasons such as potential fajita wars, landlords will typically resist granting exclusive rights. However, many retail tenants and some office tenants want exclusive use covenants which will protect them from competitors leasing space in the same property. A landlord may be prepared to agree to protect the tenant's use (for instance, by agreeing that the tenant can be the only personnel recruitment agency in a particular building or the only bank in the shopping centre) but, if the tenant with this right just closes up shop and moves around the corner, unless there is a condition in that exclusive use covenant requiring that the tenant actually occupy the premises for the right to exist, the tenant may be able to continue to monopolize that use simply by paying rent and keeping the lease current. In a shopping centre, a landlord may be able to terminate the lease because the tenant is violating the requirement that it continually operate in its premises, but in an office project where these requirements do not always exist in the lease, the landlord may have no recourse in these circumstances.

Even if a landlord has the right to terminate the lease, a requirement like this forces the landlord to do so if it wants to recapture the use – something the landlord may not want to do for economic reasons. This tenant's landlord may find itself in the unhappy position of having a steady income stream coming from vacant space but being unable to lease to a competitor of the tenant's and provide a real and needed service to its day-to-day building traffic.

All of this could have been avoided by providing that the exclusive use right dies when the tenant ceases to operate its business in the premises. If a tenant is concerned that its landlord might trigger a recapture of this right when it closes for a brief renovation or rebranding of its location, it can protect itself by negotiating some reasonable closure period during which its landlord cannot recapture this right.

If the tenant with this right just closes up shop and moves around the corner, unless there is a condition in that exclusive use covenant requiring that the tenant actually occupy the premises for the right to exist, the tenant may be able to continue to monopolize that use simply by paying rent and keeping the lease current.

3. A Co-tenancy Clause Tied to the Operation of Another Store

A “co-tenancy” requirement is one which states that, if an event occurs which is external to the relationship between the landlord and this tenant but which involves another tenant in the property, this tenant then has certain rights.

A concrete example would be an in-line retail tenant in a shopping centre which has the right to stop paying Minimum Rent if the anchor tenant three doors away closes. In a case like this, the tenant would normally get some stipulated formula for rent relief (for instance, it might only pay Additional Rent and a percentage of its sales) until the situation which triggered this change ends.

The bankruptcy of Eaton's, now a number of years ago, taught the Canadian shopping centre industry some valuable lessons in this regard.

Many Eaton's stores closed, some forever and some for a shorter time while they were being converted into Sears stores. If Sears already had a location in the property, its opening in the newly renovated former Eaton's space sometimes meant that the old Sears location closed and, once again, rights were potentially triggered.

What did landlords learn from this?

First, they learned that a co-tenancy covenant which refers to a store by name is not a good idea. For those landlords which got a renovated Sears location in an old Eaton's location, their problem was still not solved if the in-line tenant was entitled to rent reduction as long as “Eaton's” was closed.

Secondly, they learned that some things may be the same forever but lots of things change over the course of ten years. Markets that had been able to sustain multiple “department store” anchors might now be better suited to a large sporting goods store on one floor and a reconfiguration of the other department store floor into a large toy store and an electronics superstore. A co-tenancy provision which enabled the in-line tenant to pay reduced rent until the “department store” reopened would still not be satisfied with this new presenta-

tion, even though it may raise the pedestrian traffic in that part of the shopping centre and the in-line tenant itself may benefit from this new world order.

The lesson for landlords to take from this? If you have to give a co-tenancy clause, think very carefully about what you might want or need to do with the third-party space if there is ever a bankruptcy... and, never forget that you may not have as much control over that anchor space as you wish, when drafting these rights.

4. A Tenant's Right to Parking is Non-assignable

Landlords like to condition all special rights so that they only exist so long as the tenant is the original tenant (i.e., there has been no assignment of the lease), the tenant is in actual occupation of the premises (i.e., the space is not vacant or sublet) and there is not and has not been any default under the lease. This may make sense in a context where the rights are true "economic" rights, such as a right of first refusal on other space in the building, but all elements of this "word formula" may not make sense in all circumstances. Parking rights are a good example of this.

All office buildings with on-site parking will have a parking ratio of one space for each "x" square feet of space rented. If the parking being provided to a tenant under a lease is "at ratio," in other words, it does not require the landlord to provide more spaces than it would under the normal application of the building's parking formula, then normally there is no downside to the landlord in letting the rights to the parking spaces be included in an assignment of the lease or a subletting of the premises. In these circumstances, a provision which allows the landlord to automatically revoke all parking rights if the lease is assigned or the space is sublet makes no sense.

Where the parking is "above ratio," in other words, where the tenant will have more spaces than it would normally be entitled to under the application of the building standard parking formula, does it then make sense for the landlord to rescind all rights to parking if there is an assignment or sub-

letting? Not really. A more appropriate landlord solution in most circumstances is to reduce the number of permits the tenant has to the number which the tenant would get if the building standard parking ratio were applied. Using this logic, if the building standard ratio is one permit for every 2,500 square feet of space leased, but a tenant occupying 5,000 square feet has three permits, at the time of a lease assignment, one permit would be returned to the landlord but the other two – the number of permits the tenant would have if the building standard ratio were applied to their premises – would be assignable by the tenant.

From a tenant perspective, this is an important issue, since office space is much harder to assign or sublet if there is no guaranteed parking accompanying it. Because office space to be sublet rarely commands a greater rate than the original face rate, a tenant that is subletting is generally simply trying to limit the amount of losses related to its lease, not eradicate them altogether. A forced reduction in the sublet rate to compensate for the lack of parking is the wrong solution for a tenant.

5. A Requirement that the Tenant Has to Be in Occupation of its Premises in Order to Avoid the Obligation to Restore

This is more relevant to office tenants, since many retail tenants are not obligated to restore their space to base building condition. With restoration costs for some downtown Toronto office space currently running in excess of \$5.00 per square foot, however, the issue of whether or not a tenant needs to restore its space to base building condition has some considerable long-term economic impact on both parties to an office lease transaction.

When a tenant negotiates with a landlord that it will not have to restore its premises upon lease expiry, it may be faced with a standard landlord stepdown which allows it to leave the premises in broom swept condition "as long as the tenant is itself in actual occupation of the Premises."

What are landlords trying to achieve with this concept?

With restoration costs for some downtown Toronto office space currently running in excess of \$5.00 per square foot, the issue of whether or not a tenant needs to restore its space to base building condition has some considerable long-term economic impact on both parties to an office lease transaction.

The landlord is trying to protect itself from the possibility that the space may have been fully or partially sublet to a subtenant which has made some kind of alteration to the premises that will increase the cost of the restoration or, alternatively, decrease the landlord's ability to re-lease the space "as is."

While these are valid considerations, the result of using the generic wording may exceed the actual needs of the parties.

If the landlord is concerned about alterations being made by a subtenant which are unacceptable to it, it can retain the right to inspect and approve all plans and specifications for any work being done in the premises which requires a building permit or, if wiring is an issue, for any new wire being pulled in the premises. This can be specifically written into a consent to sublease so that there is a clear understanding that the landlord is entitled to re-open the restoration requirement for this kind of new work but not for the original tenant build-out. The tenant/sublandlord can require the subtenant to pay for any costs associated with this restoration and so protect itself.

On the other hand, if a tenant vacates its premises three

months early because its new space is ready, a bill for the full cost of restoration when it thought it had been relieved of that burden is an unexpected result, to say the least! Instead, the tenant will want to pursue an approach which allows the parties to make a distinction between a space which has been sublet and which requires new rules regarding new construction and a space which is simply vacant – a more logical outcome.

Conclusion

Even with well thought-out, carefully drafted documents, there is a constant need to ensure that the documents reflect the deal which the parties intend to make, not a more generic form of transaction.



Celia Hitch is counsel in the Real Estate Group in Toronto. Contact her directly at 416-307-4029 or chitch@langmichener.ca

Landlord's Remedies: Application of the Oppression Remedy Against Corporate Affiliates of a Defaulting Tenant

J.S.M. Corporation (Ontario) Ltd. v. The Brick Furniture Warehouse Ltd. et al.

Introduction

A recent decision of the Ontario Superior Court of Justice illustrates the potential utility for landlords of the broad discretionary powers available under the oppression remedy provisions of Canadian business corporations statutes.¹ Notwithstanding the clear desire of the tenant in that case to isolate the lease through the use of shell companies, the landlord's claim against the tenant's affiliated operating companies was successful.

In *J.S.M. Corporation (Ontario) Ltd. v. The Brick Furniture Warehouse Ltd. et al.*, a decision of Justice Peter Cumming of the Ontario Superior Court of Justice released March 2, 2006,² damages resulting from the breach of a commercial lease were awarded against affiliates

of the tenant. The tenant was a shell corporation which had vacated the premises before the end of the term, in circumstances

where the Court found that the affiliated defendants had first created reasonable expectations and reliance on the part of the landlord that the rental obligations under the Lease would be met, and then defeated those reasonable expectations through "invidious corporate and contractual maneuverings."

Facts

The relevant (and complicated) facts are briefly summarized below.

- On June 16, 1986, The Brick Furniture Warehouse Ltd. ("Brick Ltd."), leased space in a commercial plaza owned by the Landlord in Windsor, Ontario (the "Lease").

Notwithstanding the clear desire of the tenant in this case to isolate the lease through the use of shell companies, the landlord's claim against the tenant's affiliated operating companies was successful.

- The Lease provided that Brick Ltd. could not assign the Lease without the prior written consent of the Landlord, but that Brick Ltd. could sublet the premises to an affiliated company with notice but without consent (with one exception not relevant to the matters in issue).
- On April 1, 1987, Brick Ltd. assigned its interest in the Lease to The Brick Furniture Warehouse Windsor Ltd. (“Brick Windsor”) and Brick Windsor entered into a sublease for the premises with The Brick Warehouse Ltd. (“Brick Warehouse”).
- On June 1, 1987, Brick Warehouse assigned its interest in the sublease to The Brick Warehouse Corporation (“Brick Corp.”).
- Brick Warehouse and Brick Corp. were operating companies that had substantial assets, while Brick Furniture and Brick Windsor were shell corporations.
- On June 1, 1987, by a Consent and Acknowledgement, the Landlord, Brick Warehouse and Brick Corp. acknowledged that the sublease was in good standing and that the business conducted on the premises was being sold to Brick Corp. by Brick Warehouse. Brick Corp. agreed to comply with all the terms of the sublease and that the Landlord retained all of its rights under the Lease and sublease.
- Around March 1988, Brick Windsor and Brick Warehouse entered into an amended sublease (nominally dated April 1, 1987), which included a provision permitting termination of the sublease on 90 days’ prior written notice.
- However, the Landlord had no knowledge of the amended sublease and understood at all relevant times that the original sublease remained in place.
- Justice Cumming found that the 90-day notice of termination provision required the consent of the Landlord as it represented a fundamental change to the original sublease, and that the amended sublease was therefore of no force or effect insofar as the Landlord was concerned.
- Effective March 1, 1988, Brick Warehouse and Brick Corp. amalgamated as Brick Warehouse Corp. (Brick Corp. #2). In February 1989, Brick Corp. #2 assigned its interest in the sublease to a company which later changed its name to The Brick Warehouse Corporation (“Brick Corp. #3”).
- On January 17, 1996 Brick Corp. #3 exercised its option to renew the sublease for five years and Brick Windsor notified the Landlord accordingly, with the effect that the term of the Lease was extended to September 29, 2001.
- Effective March 31, 2000, Brick Corp. #3 vacated the premises, purporting to rely upon the 90-day termination provision in the sublease, and Brick Windsor ceased paying rent to the Landlord.
- The Landlord was unsuccessful in finding a new tenant and ultimately decided to sell the premises. The sale was completed in June 2000.

Justice Cumming found, among other things, that although there was no covenant from Brick Corp. to pay rent directly to the Landlord, there were representations and undertakings by Brick Corp. that the rent under the sublease would be paid, and that Brick Corp. made those representations for the purpose of inducing the Landlord to consent to the assignment.

Decision

In coming to his decision to award relief to the Landlord under the oppression remedy, Justice Cumming found, among other things, that although

there was no covenant from Brick Corp. to pay rent directly to the Landlord, there were representations and undertakings by Brick Corp. that the rent under the sublease would be paid, and that Brick Corp. made those representations for the purpose of inducing the Landlord to consent to the assignment. When Brick Corp. vacated the premises upon the 90-day termination clause, Brick Corp. breached the “reasonable expectations” of the Landlord.

Justice Cumming also found that it was oppressive for Brick Windsor to seek to allow its sub-tenant, Brick Ware-

house, to escape its obligations to pay rent to Brick Windsor, and for Brick Windsor to relieve Brick Warehouse's assignee, Brick Corp., from its similar obligation to pay rent to Brick Windsor. He concluded that the only reasonable inference that could be drawn from the evidentiary record was that the Brick enterprise was "attempting (through the ineffectual amended sublease) to provide an escape hatch for the enterprise, from the rental obligation, in the event that it was expedient to relocate the Brick Enterprises business It was the intent of the Brick enterprise, and of Brick Corp in particular, that in a relocation situation, [the Landlord] be left seeking rent from the shell corporations, Brick Ltd. and Brick Windsor."

Conclusion

In the result, Justice Cumming held that the corporate defendants were, as a consequence of their oppressive conduct, jointly and severally liable to the Landlord for damages equal to the unpaid rental amounts due under the Lease between April 1, 2000 and September 30, 2001, the end of the term of the Lease. Justice Cumming rejected arguments by the corporate defendants that they should not be held liable for

damages occurring after the date of the sale of the property, in part because he accepted that a reduction in the purchase price was in substantial part due to the fact that it was known that the Brick had vacated the premises.

However, claims against the individual defendants for inducing breach of contract and interference with economic relations were dismissed on the basis that they acted throughout in their capacities as corporate officers of the defendant corporations.



John Contini is a partner in the Toronto Litigation Group. John frequently acts on lease remedy matters and other real property litigation. Contact him directly at 416-307-4148 or jcontini@langmichener.ca

- 1 In this case, the statutes in issue were the Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9 and the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44. The *Ontario Business Corporations Act*, R.S.O. 1990, c. B.16 contains similar provisions.
- 2 The decision of Justice Cumming has been appealed by the defendants to the Ontario Court of Appeal, and the plaintiffs have cross-appealed.

Implications of B.C.'s New Parking Tax

Introduction

Recent provincial legislation in British Columbia to include a levy on commercial parking spaces may force commercial property owners to explore new measures for dealing with rising operational costs. As such, it is valuable for companies to be aware of these changes and what it means to their bottom line.

A Closer Look at the Parking Tax

On December 6, 2005, the *Greater Vancouver Transportation Authority Amendment Act* (B.C.) (the "Act") was brought into force. The Act implemented a new parking tax on non-residential parking spaces and authorized the Greater Vancouver Transportation Authority

The Act implemented a new parking tax on non-residential parking spaces and authorized the Greater Vancouver Transportation Authority to levy the tax annually, effective January 1, 2006.

(“TransLink”) to levy the tax annually, effective January 1, 2006. The tax applies to common areas, loading docks, driveways, bike racks, green space and storage areas, but excludes universities, schools, hospitals, municipal property and churches.

Similar to property taxes, the responsibility falls to individual municipalities to collect taxes and to then direct revenues to TransLink. As such, parking tax assessments are included in municipal property tax notices and must be paid by the property owner along with, and in the same manner as, municipal property taxes.

TransLink has suggested various grounds for imposing the new parking tax, including the need to fund expansion of roads and transit services in the Greater

Vancouver Regional District. The tax, in the view of TransLink, acknowledges the reliance of business owners on roads and transit systems to provide goods, services, staff and customers to and from their locations. TransLink also believes that a tax based on parking recognizes the demands that owners, tenants, employees, suppliers and customers of stores, shopping malls, business and industrial parks and other organizations place on existing transportation systems. Revenues from the parking tax are expected to fund \$1.9 billion in transportation improvements over the next three years.

In the early 1990s, Ontario imposed a Commercial Concentration Tax on commercial properties larger than 200,000 square feet and on commercial parking lots in the Greater Toronto Area, but such taxes were repealed after about three years. As with the B.C. parking tax, revenues were to fund transit and road programs. However, one of the major criticisms was that it generated revenues from Toronto businesses and parking lots that were used across the province. The B.C. parking tax has avoided this issue by directing the revenues to Translink.

Parking Tax Rate

The amount of parking tax owing is calculated by multiplying the parking tax rate by the taxable parking area of the site. The rate was initially set at approximately \$1.02 per square metre, equivalent to about \$30 per parking space per year. However, TransLink has since reviewed the figure and reduced it to \$0.78 per square metre (or about \$23 per parking space per year).

Challenging Parking Tax Assessments

The Act also allows property owners to file complaints where they believe they have been incorrectly assessed. Prior to implementing the new levy, TransLink created a parking site roll. A parking site roll provides information with respect to the ownership, location and taxable parking area for each property liable to assessment of the parking tax under the Act.

Accordingly, the Act enables the property owner to file a complaint against an entry in a parking site roll on any of the following grounds: (1) an error or omission respecting the property owner assessed in the parking site roll; (2) an error or omission respecting the determination of taxable parking area or taxable parking spaces; (3) the improper determination of land or improvements as a parking site; (4) an exemption being improperly disallowed; and (5) an error or omission in the apportionment of property. All complaints advanced by a property owner will be governed by the provisions of the *Assessment Act* (B.C.), which oversees property assessments throughout British Columbia. To initiate the complaint process, a property owner must file a notice of their complaint with TransLink.

Owners of commercial and non-residential rental property will want to review the terms of their existing lease agreements to determine if they can pass on the parking tax to their current tenants.

Conclusion

With the introduction of the parking tax and the shared belief that the tax will rise in the years ahead, business owners will face an indefinite increase in the cost of doing business. Owners of commercial and non-residential rental property will want to review the terms of their existing lease agreements to determine if they can pass on the parking tax to their current tenants. Standard form leases should also be revised to ensure that the tax is clearly passed on to tenants with

respect to future tenancies. The tax should also be factored into annual budgets and operating cost estimates with a view to recover any increases.

For further information, visit www.translink.bc.ca/ParkingTax/default.asp.



Shanah Ali is an associate in the Real Estate Group in Vancouver. Contact her directly at 604-691-6836 or sali@lmls.com.

Events

Lang Michener Sponsor of 5th Annual RealLeasing Conference

October 3, 2006

Metro Toronto Convention Centre, North Building
Toronto, ON

Presented by the Real Estate Property Association of Canada, RealLeasing is a forum for owners, landlords, users and tenants to tap into strategies, current issues, practices and trends in Real Estate Leasing for office, industrial, and retail applications. This conference provides an opportunity for high level executives to analyze and enhance their leasing strategies and to gain greater insight into the trends, challenges and issues that permeate the industry.

In addition to being a proud sponsor of RealLeasing 2006, **William Rowlands** and **Celia Hitch**, members of our Toronto Real Estate Group, will be contributing as discussion panelists.

Lang Michener Panelists:

11:00 a.m. “What Are U.S. and Foreign Parent Companies Demanding in Leases for Their Canadian Operations”

Panelist: **William Rowlands**

1:15 p.m. “Hurricanes, Terrorists, Pandemics and Force Majeure: Understanding the Implications of Damage and Destruction Clauses in Leases”

Panelist: **Celia Hitch**

For more information on this event, or to register, please visit the www.realestateforums.com/realleasing/program.html.

ICSC 2006 Canadian Convention – Deal Making and Trade Exposition

September 19–20, 2006

Metro Toronto Convention Centre, North Building
Toronto, ON

Presented by the International Council of Shopping Centers, the 2006 ICSC Canadian Convention – Deal Making and Trade Exposition is the definitive association event for the Canadian shopping centre and real estate industry, attracting over 1,500 participants from across the country. Lang Michener is proud to be an exhibitor at this year’s event. Stop by booth 1206 and meet members of our Toronto Real Estate Group. We look forward to seeing you there.

For more information about this event, or to register to attend, please visit www.icsc.org.

Editor: William A. Rowlands
416-307-4065
wrowlands@langmichener.ca

RETURN UNDELIVERABLE CANADIAN ADDRESSES TO:

Lang Michener LLP
BCE Place
181 Bay Street, Suite 2500
P.O. Box 747
Toronto ON M5J 2T7
Tel.: 416-360-8600 Fax.: 416-365-1719
e-mail: info@langmichener.ca

Lang Michener LLP

Lawyers – Patent & Trade Mark Agents

Toronto
BCE Place
181 Bay Street, Suite 2500
P.O. Box 747
Toronto, ON M5J 2T7
Tel.: 416-360-8600 Fax.: 416-365-1719

Vancouver
1500 Royal Centre
1055 West Georgia Street
P.O. Box 11117
Vancouver, BC V6E 4N7
Tel.: 604-689-9111 Fax.: 604-685-7084

Ottawa
Suite 300
50 O’Connor Street
Ottawa, ON K1P 6L2
Tel.: 613-232-7171 Fax.: 613-231-3191

Lang Michener publishes newsletters on current developments in specific areas of the law such as Competition and Marketing, Insurance, Intellectual Property, International Trade, Privacy, Real Estate, Securities and Supreme Court of Canada News.

Brief offers general comments on legal developments of concern to business and individuals. The articles in *Brief* are not intended to provide legal opinions and readers should, therefore, seek professional legal advice on the particular issues which concern them. We would be pleased to elaborate on any article and discuss how it might apply to specific matters or cases.

Our privacy policy is available on-line at www.langmichener.ca