



RealEstateBrief

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Most sophisticated commercial leases have very extensive controls on the ability of a tenant to assign its lease, sublease the premise or otherwise part with or share possession of the premises. The provisions may be applicable in some surprising circumstances. In our first article Mark A. Richardson reviews the common issues arising out of these lease provisions.

In our second article Matthew German provides a brief overview of the basic elements of Ontario's *Construction Lien Act*. This Act is often credited with facilitating the expeditious and inexpensive resolution of construction disputes. As the article points out, in order to take full advantage of this legislation, those dealing with the construction industry need to ensure that they have a strong understanding of the Act and be prepared to meet its obligatory time limits.

Assignment and Sublet Issues for Tenants

Introduction

Tenants should pay careful attention to the applicable provisions of their leases before entering into any type of arrangement to give or share their premises with others. Leases commonly contain restrictions on the use and occupancy of leased premises by parties other than the tenants. Before making commitments and deciding on the structure of arrangements, tenants should consider what they are permitted to do and on what conditions in order to avoid breaching the terms of their leases or encountering unexpected consequences.

Lease Restrictions

Leases ordinarily restrict assigning, subletting and/or giving up rights to the use or occupancy of leased premises (often collectively referred to as transferring).

What is Restricted?

Assignment by a tenant takes place when the interest of the tenant under the lease in the leased premises for the remainder of the term is conveyed to a third party. The third party steps into the shoes of the tenant under the terms of the lease.

A sublease is created when what is conveyed by the tenant is a portion only of the leased premises or when the conveyance is for a term ending prior to the expiry of the term of the lease. The terms of the sublease may vary from, but may not be inconsistent with, the terms of the lease.

Not every occupation by a third party is a subletting. For example, where the tenant has a right to concurrent use with the third party or has a right of access at any time or has effective control of the premises occupied, there may not be a sublease but rather a licence or sharing of possession. A particular licence arrangement may or may not be caught by the wording of the lease. An outsourcing arrangement allowing a service provider into the premises may require consent.

Conditions

The provisions of a lease restricting assignment, subletting and/or certain licensing often impose conditions on a permitted transaction. Some examples of common conditions (which should be kept in mind when a tenant is planning or negotiating a proposed transaction) are as follows:

- a permitted assignee (or subtenant) must agree directly with the landlord to observe the terms of the lease;

- no further assignment or subletting is permitted without the landlord's consent; and
- the tenant is not released from its obligations (even if the lease is amended, further transferred, extended or renewed).

Other conditions may be particularly onerous to the tenant. Consider the following illustrations:

- the tenant is to pay to the landlord any increase in rent received under a sublease in excess of the rent provided under the lease;
- upon receipt of a request for consent, the landlord has the option of terminating the lease or of terminating the lease with respect to the portion to be sublet (perhaps with a right of the tenant to withdraw its request if the landlord so elects); and
- the basic rent may be automatically increased, for example, to current market rent or to the aggregate of basic rent plus percentage rent (if there is percentage rent) last payable under the lease.

Exceptions

At the time of entering into a lease it may be possible to negotiate for exceptions to some or all of the transfer restrictions. Some examples are as follows:

- a transfer to a related corporation, for example, an affiliate (generally a parent or subsidiary) under the governing corporate legislation;
- a corporate reorganization such as an amalgamation; and
- a transfer to a purchaser of a number of locations of the tenant (especially in the case of a retail chain).

Landlord's Consent

In most cases, the tenant is permitted to carry out the restricted transfer only if the tenant obtains the landlord's consent, usually with such consent not to be unreasonably withheld. Under the *Commercial Tenancies Act*, a lease is deemed to include a provision that the landlord's consent is not to be unreasonably withheld, unless the lease provides otherwise.

Specific Conditions

A lease may specify certain conditions that a landlord may have regard to in deciding whether or not to give its consent in order to broaden the scope of the landlord's consideration. Consider the following examples:

- not less than a certain period has elapsed since the commencement of the term (to prevent the premises from being frequently churned);
- the third party is not an existing tenant of the landlord (whether in the particular property or any other property

owned by the landlord in the vicinity) (to prevent the tenant from competing with the landlord's leasing program);

- the proposed transfer could result in the violation of a covenant made by the landlord in favour of another tenant at the property, for example the grant of exclusive use rights; and
- the rent payable by the third party would be less than the rent payable under the lease (to prevent a detrimental effect on the leasing of other premises at the property).

Proper and Improper Grounds for a Landlord Withholding Consent

It is a question of fact in each case whether a consent has been reasonably or unreasonably withheld. There is a large body of case law in which the courts have set out general principles.

The courts have considered a landlord's refusal to grant consent to be unreasonable in the following circumstances:

- a desire by a landlord to have the premises vacant or obtain a higher rent;
- a landlord seeking amendments to the lease in order to obtain a commercial benefit for itself; and
- a landlord objecting to a proposed change in use which is not fundamentally different than the uses permitted under the lease.

The following have been found to be reasonable grounds for a landlord withholding consent:

- a genuine desire by a landlord to maintain the character of a shopping centre;
- prevention of the establishment of a business which would make it more difficult to lease other premises at the property; and
- objections to a new business which would inconvenience other tenants by causing congestion in the parking lot.

Unexpected Consequences

Even if the proposed arrangement, subletting or licensing by a tenant is permitted under its lease, there may be unexpected consequences to the tenant by reason of provisions of the lease other than the provisions restricting transfers.

Loss of Rights

Certain rights of the tenant under a lease may be qualified such that the rights only exist if certain conditions are met. Rights which may be so qualified include rights of renewal or extension, rights of first refusal, rights of expansion, rights of early termination, exclusive uses and co-tenancy rights. An assignment, sublease or other arrangement (even with consent) could result in the loss of these rights.

Terms of Transfer

In order to properly consider the terms of a proposed sublease or licence, it is necessary to review the lease to consider which terms should and should not apply as between the tenant and the subtenant or licensee. For example, the tenant may not want to give the subtenant or licensee certain special rights such as rights of renewal or options to purchase. The tenant may not want the subtenant or licensee to be able to further assign or sublet its interest. The tenant should not want to assume all of the obligations of the landlord, for example the obligation to make structural repairs, but should only be responsible for enforcing the landlord's obligations. The simple incorporation of all the terms of the lease into the arrangement may not be appropriate.

Conclusion

This article is intended to highlight and present an overview of some matters of which tenants should be aware with respect to their leases before entering into any arrangement to allow others into their premises. It is not meant to be exhaustive in any respect. Any proposed transfer of rights by a tenant may include many other considerations both at law and under other contracts.



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The Construction Lien Act – Understanding the Basic Rights and Obligations

Introduction

Those involved in the construction industry are continually faced with financial risks not encountered in other commercial contexts. These financial risks stem from the fact that most construction work is carried out by different construction trades people who have no privity of contract with the owner of the project and who work without any form of security.

As a result of these risks, contractors and suppliers of work, services and supplies to real property in Ontario have been granted special protections by the *Construction Lien Act* (the "CLA"). The CLA sets out the rules as to who has a lien (security against the property) and the process by which lien claimants can enforce their various rights.

Section 14(1) of the CLA provides that, "a person who supplies services or materials to an improvement for an owner, contractor or subcontractor, has a lien upon the interest of the owner in the premises improved for the price of those services or materials." The lien creates an interest in the land in favour of those who supply materials or services, thereby creating security. This operates to prevent the owner from receiving improved land without making payment for the improvement. This is especially important to subcontractors who have no direct contract with the owner (and therefore no right to bring an action for payment under a contract).

The Holdback Requirements

In most cases, the flow of funds under a construction project contemplates payments being made as the work progresses

from the owner down to the contractors, subcontractors, and those claiming under them. It is often referred to as the "construction pyramid."

Part IV of the CLA provides that each payer on a contract or subcontract is required to retain a holdback of 10 per cent of the price of the services or materials as they are actually supplied under the contract or subcontract until all liens that may be claimed against the holdback have expired or have otherwise been satisfied or discharged. The term "payer" is defined in section 1(1) of the CLA as meaning "the owner, contractor, or subcontractor who is liable to pay for the materials or services supplied to an improvement under a contract or subcontract." The purpose of this holdback is to create a fund to which lien claimants may look if they are unable to recover from the person with whom they have a direct contract.

In addition to the basic holdback, there is a separate holdback for finishing work completed after the date of substantial performance of the contract.

Provided that the owner retains the proper holdback over the course of the construction and otherwise complies with its statutory obligations, the owner's exposure to a subcontractor or supplier lien claimant, with whom the owner has no direct contract, will be limited to the amount of the holdback.

Time Limits for Enforcing a Claim for Lien

Once it is established that one has a claim for lien, it is important to maintain those lien rights and enforce them. If certain

steps or dates are missed, it could be costly to the lien claimant who is trying to enforce its lien rights. The CLA sets forth specific time limits for a claim for lien, first, to be preserved by registration against the title to the property, and second, to be perfected by the commencement of a court action.

The lien must be preserved by the claimant's registration of a claim for lien within 45 days after the earliest of publication of a certificate of substantial performance of the contract or the date the contract is completed or abandoned in the case of a contractor, or the last supply or certification of completion in the case of a subcontractor.

The next step that has to be taken to maintain and enforce the lien right is to commence an action to enforce the lien prior to the end of the 45-day period next following the last day on which the lien could have been registered. Therefore, the action must be commenced within ninety days of the last supply of services or materials. If this step is not taken within that time period, the lien will expire and the lien right will be lost.

There are also circumstances by which a preserved lien of a lien claimant may be perfected by "sheltering" under the perfected lien of another lien claimant in respect of the same improvement. However, in order to ensure one has adequate pleadings to proceed with the action, it is recommended that each lien claimant commence its own action rather than rely on the "sheltering" provision.

It is also important to note that a claim for lien will become void and unenforceable in the event the action commenced to perfect the claim for lien is not set down for trial within a period of two years from the date of commencement of the action.

Vacating the Lien

If a construction dispute arises and a lien is registered against an owner's property, often there will be a quick resolution to this dispute, especially if the owner wishes to deal with his property.

An owner with a lien on his property will have to remove it from title before any prospective purchaser will close a transaction. In order to clear title, the owner has a few options available. Security can be posted into court for the full amount of the claim plus 25 per cent for costs in order to vacate the lien from title, or the owner can negotiate with the lien claimant for the payment of an amount sufficient enough to settle the lien in exchange for a discharge.

While a discharge of the lien is ideal, if the lien is vacated, it will no longer attach to the land, and any prospective purchaser can be satisfied that the property is not encumbered.

Conclusion

There is very little other legislation in Ontario that provides parties entering into agreements with the type of protection offered by the CLA. Construction trades are often working without any other form of security or contract with the property owner. Not only does the CLA provide a method for assuring that there will be a source of funds available for those with a valid claim for lien, but the CLA can also be credited with facilitating the expeditious and inexpensive resolution of construction disputes.



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