MINDEN GROSS LLP

Summer 2014

TOPICS:

Recent Developments of Importance in Property Leasing

Shelf Life of an Indemnity

1212763 ONTARIO LTD. V. BONJOUR CAFÉ examines whether an assignor's indemnity agreement can be enforced by a landlord following an assignment of an amendment to the lease. In this case, the Landlord sought to recover unpaid rent from prior operators of a coffee shop. The Landlord originally entered into a lease with the Tenant, Bonjour Café, for a term of five years from February 1996 to February 2001. The coffee shop was run by a revolving door of operators as the Lease was assigned six times between 1996 and 2004. The Lease was first assigned to 1312215 Ontario Inc. (the "First Assignee") in 1998. The Landlord consented to the assigned and agreed to extend the Term to February 2006 (the "First Extension Term"). Upon each assignment, the Landlord required the assignor to sign an agreement indemnifying the Tenant's obligations under the Lease throughout the Term, notwithstanding any subsequent assignments. The principal of one assignor, Café Ebenezer, signed a supplementary indemnity agreement that was to apply throughout the Term and "any extensions thereof".

In 2004, the final assignee extended the Lease to February 2009 (the "Second Extension Term") and the rent payable was increased starting in the Second Extension Term. The Landlord did not notify the former assignees about the rent increase. When the last assignee stopped paying rent in 2005, the Landlord terminated the Lease, leased the space to a third party at a significantly lower rate, and brought an action to recover lost rent from two of the operators — the First Assignee and Café Ebenezer.

The Court held that the former assignees were *not* released from their obligations under the indemnity agreements when the Lease was assigned without

their knowledge. The assignments did *not* constitute a material change to the Lease, as they did not alter the rights and obligations of the parties under the Lease. As well, the 2004 amendment had no effect on the indemnity obligations of the assignees during the First Extension Term since the rent increase did not come into effect until the Second Extension Term. Accordingly, the Court found both assignors liable for rent up to February 2006.

However, neither assignee was found liable for any rent during the Second Extension Term. The First Assignee's liability was limited to "the Term" which, at the time, included only the First Extension Term. So what about Café Ebenezer, whose supplementary indemnity clearly applied to the Term and "any extensions thereof"? The Court indicated its liability would have continued throughout the Second Extension Term had the Lease simply been extended. However, Café Ebenezer's consent was required for the increased rent and since it was not obtained, the Court held that the supplementary indemnity was terminated when the rent increase took effect.

Why wasn't Café Ebenezer liable for anything during the Second Extension Term, even the base rent payable for the last year of the First Extension Period? The Court ruled that termination of the indemnity "is the effect of the application of common law rules. The amendments are not to be read as if the Landlord extended the Lease on the same terms and conditions."

Bonjour Café demonstrates the importance for landlords to incorporate express language in their leases, consents and indemnity agreements, that (i) stipulates liability will continue during the initial Term of the Lease and "any renewals or extensions thereof" and (ii) contemplates rental increases during the renewal/extension terms. We question whether a clause in the indemnity, which provided that the assignee would remain liable for the fair market rent during any extension period, would have been sufficient to avoid termination of the indemnity and enable the Landlord to recover some rent from Café Ebenezer during the Second Extension Term.

Insurance Protection Extends Beyond the Lease

In *Williams-Sonoma Inc. v. Oxford Properties Group Inc.*, Williams-Sonoma was a tenant at Yorkdale Shopping Centre when the mall was undergoing renovations. The Landlord, Oxford Properties Group Inc., hired EllisDon Corporation ("EllisDon"), an independent contractor, to perform the construction work. During the course of their work, a vandal opened a fire hose in a vacant area that was being used by EllisDon and, as a result, the Tenant's premises suffered extensive water damage of approximately $7 million. Williams-Sonoma sued EllisDon for breach of common-law and statutory duty owed to the Tenant by failing to properly secure the area where the fire hose was located. EllisDon brought a motion for summary judgment arguing that in the Lease the Tenant had waived its rights to claim against the contractor. The motion judge granted summary judgment and dismissed the Tenant's claims, holding that the benefit of the exculpatory clause in the Lease should extend to the contractor.

The Lease required the Tenant to maintain insurance coverage for water damage. The Lease also contained an exclusionary clause, whereby the Tenant released the Landlord and waived all claims against the Landlord and "those for whom the [Landlord] is in law responsible" with respect to occurrences insured against or required to be insured against by the Tenant, whether any such claims arise as a result of the negligence or otherwise of the other or those for whom it is in law responsible.

The motions judge focused on the doctrine of privity and interpretation of the phrase "in law responsible" and applied the two-part test established in *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, to determine whether the doctrine should extend to a third party:

1. Did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision; and
2. Are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the contract in general or the provision in particular, as determined by reference to the intentions of the parties.

The motions judge concluded that the Landlord and Tenant did intend to extend the exclusionary clause to those parties involved in the mall renovation, and since EllisDon was performing the very activities contemplated in the Lease, both prongs of the *Fraser River* test were satisfied.

The Court of Appeal agreed with the motions judge, and further analyzed the term "in law responsible". If not for the exculpatory clause, the Landlord would

have been responsible for the damage caused by the contractor and liable under the indemnity clause. The Court concluded that the Landlord had made itself "in law responsible" for EllisDon as its contractor and as a result, EllisDon was protected by the Lease.

This case demonstrates that the doctrine of privity may extend beyond the scope of the parties to a Lease and that a third party, who is not a party to the Lease, may be exculpated from liability by an exclusionary clause. This case appears to be consistent with the lower court decision in *Harlon Canada Inc. v. Lang Investment Corporation*, where the Court held that a claim against the Landlord's independent contractor was barred by the Lease. The decisions in both *Harlon Canada* and *Williams-Sonoma* imply that a third party contractor is a person for whom a landlord is in law responsible, which is not correct in the author's opinion.

Did the Tenant Exercise Its Option to Renew?

Money Mart Canada Inc. v. Austrocan Investments Inc. originally entered into a Lease agreement in 1989. In 2003, a new Lease was signed for a five-year term and granted an option to renew for an additional five-year term. On December 2, 2008 (the "December Notice"), the Tenant sent a letter to the Landlord purporting to exercise the option to renew the Lease. The December Notice also proposed further changes to the Lease, such as a definition of permissible uses and for the right to terminate in certain circumstances. The parties were never able to come to an agreement on the "other changes" and on September 1, 2010, the Landlord delivered written notice to the Tenant terminating the tenancy. Following several extensions of the termination date, the Tenant vacated the premises in April 2011. At issue was whether the December Notice constituted a valid exercise of the option to renew. The Landlord claimed that it did not while the Tenant claimed it was valid.

The Court considered the surrounding circumstances in determining whether the Tenant demonstrated an unequivocal and unambiguous intention to negotiate a new lease or renew the existing Lease. Although a paragraph in the December Notice expressed a desire to exercise the option to renew, other paragraphs discussed the possibility of amending, deleting or adding various clauses, which was contrary to the wording of the right to renew that called for a renewal on the same terms and conditions as in the original Lease. Further, the letter ended with the statement "if you are in agreement with this proposal." Reading the letter as a whole and the surrounding circumstances, the Court ruled that the December Notice was not a clear and unambiguous exercise of the right to renew. Therefore, the Lease expired and the tenancy was converted to a month-to-month lease.

In *Rinaldo Hair Stylist Ltd. v. bcIMC Realty Corp.*, the Tenant, a hair salon, entered into a Lease with the Landlord in 1998 for a 10-year term expiring May 2008. The Lease contained a renewal option for two additional five-year terms on written notice to be delivered by May 31, 2007. The Landlord's leasing agent was engaged in ongoing renewal negotiations with the Tenant, but as of March 2007, the parties were far apart on renewal terms. By July 2007, the Tenant had been silent for two months and the agent then notified the Tenant by letter of the Landlord's decision to terminate negotiations and pursue other potential tenants. Following the letter, the Tenant and the Landlord's agent re-engaged in negotiations and the agent sent another letter to the Tenant in August 2007 asking whether the Tenant was interested in a renewal. The Tenant did not respond to the Landlord's inquiry and the Landlord notified the Tenant in October 2007 that they would be required to vacate the premises on or before May 31, 2008.

The Tenant brought an action claiming that the Landlord's conduct throughout negotiations led them to believe that the Landlord waived the strict written notice requirement for renewal under the Lease. The Landlord countered by bringing an application for summary judgment. The application was granted and the action was dismissed. The judge found that no conduct on behalf of the Landlord would have reasonably led the Tenant to infer that the strict compliance with written notice for renewal had been waived. The negotiations were conducted by the Landlord in good faith and even though negotiations were constant, the two parties were far from agreement. The negotiations that took place after the renewal notice was required were negotiations outside of the Tenant's renewal option and outside any restrictions the Lease may have imposed. The Court of Appeal dismissed the appeal and determined that the case was appropriate for summary judgment.

Tenants Beware: Do not taint your exercise notice with proposed changes to your lease. Keep them separate and distinct. If you decide not to exercise your option

unless certain lease amendments are obtained, then negotiate the amendments separately before you exercise the option to extend/renew and well before your exercise period expires. The extension/renewal and lease amendments may be documented in the same agreement, but avoid making your exercise notice conditional on new proposed amendments.

Overholding Tenant? No So Fast

In *Aim Health Group Inc. v. 40 Finchgate Limited Partnership*, the Ontario Court of Appeal overturned a recent lower court decision regarding a tenant's rights to overhold on a lease. In this case, the Term of the Lease ended on December 31, 2011, but the Tenant informed the Landlord that it would need more time before it could relocate to other premises. The Landlord informed the Tenant that it needed vacant possession of the premises on December 31, 2011, as it had found a new tenant. On January 1, 2012, the Landlord changed the locks and a few days later removed the Tenant's property from the premises. The trial judge held that the Tenant was a validly overholding tenant on a month-to-month basis.

There was a collective sigh of relief by Canadian landlords when the Court of Appeal reversed the lower court decision and re-affirmed the rights of a landlord to oust an overholding tenant. The Court held that the Tenant could not unilaterally stay in the premises beyond the expiry date without the Landlord's consent. The Court noted that a landlord's consent can be implied if a landlord accepts rent during an overholding period. However, in *Aim Health* the Landlord clearly stated its intention to re-take possession at the end of the term and had not accepted any rent during the overholding period.

Parking Ratio

In *Farm Boy Inc. v. Mobius Corp.*, the Ontario Court of Appeal upheld the trial Court's finding in favour of the Landlord and dismissed the Tenant's appeal. At issue was the interpretation of the phrase "Area of Premises", as it was not clearly defined in the Lease. The Lease required the Landlord to maintain a parking ratio of 5.5 parking spaces per 1,000 square feet of "Area of Premises".

The Tenant brought an action against the Landlord for a breach of contract claiming that the parking ratio was applicable to the entire Shopping Centre and therefore the parking ratio failed to provide the Tenant with the required number of parking spaces. The Tenant claimed its business suffered and led to a loss of profits. The Landlord took the position that the parking ratio only applied to the Tenant's Premises and not the entire Shopping Centre. Even if it was found that the parking ratio applied to the entire mall, the Landlord claimed that the Tenant was unable to provide sufficient evidence of actual damages suffered. The Landlord relied on *Merger Restaurants (c.o.b) Shakey's Restaurant v. D.M.E. Foods Ltd. (c.o.b. Bonanza Restaurant)*, which showed that in the case of a proven breach of contract, damages cannot be recovered unless there is sufficient evidence proving that damages flowed from the breach.

The Court determined that the parking ratio only applied to the Tenant's Premises and not the entire Shopping Centre, but the Landlord was still found to be in breach of its parking ratio obligation. The Court noted that complaints regarding the parking ratio were generally temporary and that the parking lot generally accommodated the day-to-day needs of the Tenant's customers. In the end, the Court held that Tenant failed to prove that it suffered any loss as a result of the breach.

Based on this case, it would appear that Courts may consider the everyday use of parking lots. Even if landlords do not abide by terms of the parking ratio agreed to in a lease, they may find themselves free of liability if the general day-to-day use of a parking lot does not hinder the tenant's customers. **From a tenant's perspective**, if parking is critical to your business then it would be prudent to bargain for a contractual remedy for the landlord's failure to satisfy a parking ratio (such as rent abatement or liquidated damages) to ensure your landlord has incentive to comply.

Commercial Tenant Not Liable for Costs of Repaving Parking Lot

In *RioCan Holdings Inc. v. Metro Ontario Real Estate Limited*, the Ontario Court of Appeal found that a parking lot rehabilitation was a capital cost and must be excluded from additional rent under the terms of that Lease. Unfortunately, this case is often used by tenants who are challenging their landlord's CAM allocations, as they erroneously believe that the *RioCan v. Metro* case stands for an affirmation that landlords cannot pass through capital costs.

In *Parsons Precast Inc. v. Sbrissa* the Court was asked to settle a dispute between Landlord and Tenant over the re-imbursement of the costs to the Landlord for repaving a parking lot. The Landlord and Tenant first

entered into a Lease in October 2004 for a term of three years. The Lease was renewed twice for two additional two-year terms, ending in October 2011. The Lease contained provisions obligating the Tenant to pay on a monthly pro-rata basis for "repairs (reasonable wear and tear excepted) and maintenance" of common areas.

With just over a year remaining on the Lease, the Landlord repaved the entire parking lot and delivered a bill for $14,533 as the Tenant's proportionate share of the paving costs. The Tenant applied for a determination of whether it was liable for the repaving costs. The Tenant relied on *RioCan v. Metro* to argue that the repaving of a commercial parking lot is a capital expense and therefore could not be recovered as part of a monthly expense from a tenant. However, the Court distinguished *RioCan v. Metro* from the case at hand – and rightfully so – because of specific language in that lease which excluded "capital expenditures" from common expenses, whereas the Lease in this case had no such exclusion.

Nevertheless, *Parsons* is a worthwhile read as the Court analyzes whether the parking lot repaving would qualify as "maintenance" or "repairs (reasonable wear and tear excepted)", which were costs the Landlord was clearly entitled to pass through to the Tenant. The Court stated that: "Undoubtedly in arrangements of this type there will be a myriad of items which must be replaced in the normal course of events as an item of maintenance – for example a light bulb, or an air filter in a heating or air-conditioning system. It seems to me that other items, however, are so substantial in their nature and in their expense that they cannot reasonably be considered as an item of repair or maintenance." As well, the Court noted that "on the evidence before me it appears that the Landlord accepted the advice it had received to the effect that the wear and tear over 19 or 20 years on the original paved parking lot was such that it required to be replaced rather than repaired."

The Court concluded that the repaving project was not considered "maintenance" or "repair (reasonable wear and tear excepted)" since the parking lot was completely replaced, rather than being "fixed up", and such replacement was required as a result of wear and tear, the Tenant was not responsible for any of the repaving cost based on the wording of the Lease. The Court also considered (and deemed significant), the fact

that the Landlord billed the client for its proportionate share in a lump sum and not as part of its monthly charge. If it was wrong in characterizing the re-pavement as falling outside the realm of "maintenance" and "repair," the Court said it would make sense to amortize the payment over a period of 20 years and the Tenant would only be responsible for such amortized amount between the months of September 2010 and October 2011 when the Lease expired. From a **landlord's perspective,** the latter statement may sends chills down your spine as the Court seemed willing to read into the Lease a restriction that the Tenant ought to have negotiated itself.

MPAC Working Papers – Should They Be Used or Not?

In 1998, Ontario revamped its property tax assessment system and legislation eliminated the requirement to create separate tenant assessments on the assessment roll. Although the Municipal Property Assessment Corporation (MPAC) no longer prepares separate tax bills or assessments for each tenant of a commercial building, multi-tenant properties are valued by assessors using the Capitalization of Income approach. An assessor prepares a valuation summary that lists the tenancies at the property and then each tenancy is ascribed a market rent (not actual rent) that is capitalized. These valuation records are often referred to as the "assessor's records" or "working papers".

There have been many attempts by landlords and tenants to rely on the assessor's records as a basis for allocating taxes. In *Orlando Corporation v. Zellers Inc.*, the Ontario Court of Appeal held that the assessor's records do not constitute separate assessments. In *Sophisticated Investments Ltd. v. Trouncy Inc.*, the court held that the assessor's records do not constitute assessed values. In *658425 Ontario Inc. v. Loeb Inc.*, which affirmed *Orlando Corporation v. Zellers Inc.*, the Court ruled that assessor's records do not constitute a separate value of the Tenant's premises for property tax purposes.

At issue in *Indigo Books & Music Inc. v. Manufacturers Life Insurance Co.*, was the reliability of using MPAC working papers as a basis to determine a tenant's contribution to property taxes. The Court in *Indigo Books* noted that (i) the calculations in the working papers are informal and discretionary, (ii) they are not governed by legislation, and (iii) working papers are not intended to apply to individual premises; rather they demonstrate a value for the entire property. The Ontario Court of Appeal concluded that working papers could not be considered accurate or reliable on an individual basis. Based on the precise wording in that Lease (which provided that if the Landlord was unable to obtain "other information deemed sufficient by the Landlord to make the calculations of Additional Rent," then the Tenant's contribution would be determined on a proportionate share basis) and concluded that it was within the Landlord's discretion to deem the information in the working papers insufficient to complete the calculation of additional rent and allocate the Tenant's realty taxes on a proportionate share basis.

Given the recent trend of cases, a few recent decisions come as a surprise. In *Terrace Manor Ltd. v. Sobeys Capital Inc.*, the Tenant (Sobeys) leased space to operate a grocery store. The Lease required Sobeys to pay its share of realty taxes according to the separate assessments issued by the taxing authority. Where no such assessments were available, the Lease required the parties to make reasonable efforts to obtain "sufficient official information" to determine what such an assessment would have been. If no such information was available, the Landlord was required to allocate taxes to Sobeys having regard to "the generally accepted method of assessment utilized by the assessment authority."

The Tenant argued that the working papers produced by MPAC provided sufficient information to determine what a separate assessment would have been for its store. As such, the Tenant argued that the Landlord was obligated to bill the Tenant's share of realty taxes based on the working papers. The Landlord's position was that the working papers were not "official information" as required by the Lease and maintained that the proper method of allocation was a proportionate share calculation.

The Court agreed with Sobeys and held that the working papers qualified as "sufficient official information", noting that municipalities are required by law to use MPAC's assessment data in levying taxes. Further, the Court found that the documents provided sufficient information on how to calculate the current value of each property and had, in fact, been used by the Landlord between 2004 and 2009 to determine the Tenant's share of realty taxes. In light of this, the Landlord could not then take the position that the MPAC records could not be used to determine the Tenant's share of taxes. The Court dismissed the Landlord's application and concluded that "MPAC's

assessment for the plaza was created from assessment data, on a unit by unit basis, as shown on the evaluation records [and that] the information they contained was sufficient to determine what the taxes to the Tenant would have been if a separate assessment had been made." The Ontario Court of Appeal upheld the trial Court's decision and dismissed the Landlord's appeal. Oddly enough, the *Indigo Books* case was not specifically mentioned in the decision, but the Landlord's counsel did argue that working papers produced by MPAC were "not sufficiently reliable or created for the purpose of apportioning the tenant's share of property taxes."

Sobeys was also successful in a more recent case. In *Sobeys Capital Inc., (c.o.b. Price Chopper) v. Bayview Summit Development Ltd.*, Sobeys leased space from the Landlord to operate a grocery store. The property tax clause of the Lease provides:

> "The parties shall use their best efforts to obtain all necessary information from the municipality or other taxing authority, based on the assessor's working papers, notes and/or calculations to determine the manner in which such authority would have allocated the assessment for Taxes in respect of the Shopping Centre to the Leased Premises had an assessment…been prepared by such authority. The Landlord agrees to provide the Tenant on request, a letter of authorization to the appropriate assessing authority allowing the Tenant access to the assessor's working papers, notes and/or calculations…If such information is not available, the Tenant agrees to pay the Tenant's Proportionate Share of Taxes. If such information becomes available in the future, the Tenant's Proportionate Share of Taxes shall thenceforth be based upon such allocation, and shall not be adjusted retroactively …"

The Landlord calculated the Tenant's contribution to Taxes on a Proportionate Share basis and the Tenant brought an application to determine the proper method for calculating its share of Taxes. Not surprisingly, Sobeys argued that the Landlord ought to have calculated its share based on MPAC's working papers. Relying on the strict wording of the realty tax clause in the Lease, the Landlord maintained that MPAC was neither a "municipality" nor a "taxing authority". Relying on *Indigo Books*, the Landlord argued that the MPAC working papers cannot be considered accurate or reliable in individual circumstances.

The Court allowed Sobeys' application, noting that although assessing property value and levying property tax are two separate steps, "they are part and parcel of the overall process." The Court also noted that the parties had specifically referenced the "working papers" in the Lease (which both sides acknowledged refers to the MPAC valuation reports), and by taking the position that the MPAC is not a "taxing authority", the Landlord was "splitting hairs".

In *Bayview Summit* the Court confirmed it is perfectly reasonable for parties to choose to rely on working papers produced by MPAC in allocating taxes among units of a building. In other words, it was immaterial whether the working papers were reliable since the Landlord and Tenant had both agreed in the Lease to base the allocation of realty taxes on those documents. The Court concluded that the working paper method was the parties' preferred method of allocating taxes and that the Proportionate Share method was an alternative to be used only in the event that such information was not available. How does one reconcile the decisions in *Indigo Books* with these recent *Sobeys* cases? It appears that the precise wording in the lease is key — if the realty tax clause contemplates using the working papers in certain circumstances, this may imply an acceptance by the landlord of that methodology, which in turn could prevent the landlord from relying on *Indigo Books* to support its position that working papers are not reliable.

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Firm News

The *2014 Canadian Legal Lexpert Directory* acknowledged nine Minden Gross lawyers as leaders in their field. The firm received leading ranking in Property Leasing and Property Development. Congratulations to **Brian Levett** (Corporate Mid-Market); **Howard Black**, **Eric Hoffstein**, **Joan Jung** (Estate & Personal Tax Planning); **Reuben Rosenblatt, QC, LSM** (Property Development); **Christina Kobi**, **Stephen Messinger**, **Adam Perzow**, and **Stephen Posen** (Property Leasing).

Congratulations to **Irvin Schein**, who received his LL.M. in Alternative Dispute Resolution (ADR) from Osgoode Hall Law School in June 2014.

Professional Notes

Howard Black spoke on Estates, **Matt Getzler** spoke on Tax and **Reuben Rosenblatt** spoke on Real Estate at the CanBarPrep's program held June 16 and 17, 2014.

Irvin Schein recorded a Webiner for HRInsider in July called "Are You Employing an "Employee" or an "Independent Contractor"?" and posted on his blog at irvinschein.com.

Samantha Prasad's article "How to Realize the Value from a Private Business" was featured in the June 2014 issue of CIBC's *Master Series*.

Joan Jung co-presented "In Trusts We Trust" to the Canadian-Chinese Professional Accountants Association on July 19, 2014 with Jin Wen, CPA,CA, from Grant Thornton.

Michael Goldberg joined the Marketing Committee of the Jewish Foundation of Toronto's Professional Advisory Committee (PAC) in June 2014. Michael also hosted the fourth *Tax Talk* on June 18, 2014.

David Ullmann was honoured with the Ontario Volunteer Service Award presented on June 18, 2014.

Matt Maurer was quoted in the articles "Focus: Case a reminder about perils of dual agency" and "Building permits a significant pitfall", both published in *Law Times* on June 9, 2014. Matt continues to publish his blog at Slaw.ca.

Upcoming Events

September 18, 2014: Irvin Schein Speaker, "Overcoming the Challenges of Managing External Counsel and Techniques for Regulating the Relationship", Canadian Institutes' Forum for Corporate Counsel, Toronto.

October 6, 2014: Hartley R. Nathan, QC, and Ira Stuchberry (with David Miller of Rogers Communications Inc.) Speakers, "What Corporate Counsel Should Know About Corporate Governance", Association of Corporate Counsel, Toronto.