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EXISTING TENANTS: NEGOTIATED SOLUTIONS

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In difficult economic times, tenants may need help from their landlord in order to survive. "Help" can come in a number of forms:

(a) a landlord can promise not to enforce the strict terms of a lease for a period of time (promissory estoppel);

(b) a landlord may agree to a reduction of rent;

(c) a landlord may permit a tenant to surrender its lease before the expiry of the lease term;

(d) a landlord may relocate a tenant to smaller, less expensive premises; or

(e) a landlord may permit a tenant to assign its lease, sublet all or a portion of its premises, or sell its business to a new operator.

A landlord's decision on whether to help one of its tenants in difficult economic times is typically motivated by a desire to keep the tenant operating its business and to avoid the prospect of having the premises simply abandoned. Some of the tools a landlord can use to help a tenant may already be found in the lease agreement (e.g., a right to relocate a tenant or a right to control an assignment, a subletting or a change of control). Other solutions may be found based on a new agreement negotiated when times get tough (e.g. rent reduction agreements and surrenders of lease). Still other solutions may be found inadvertently when a landlord accepts a rent reduction or deferment without any fresh consideration from the tenant (i.e. a promissory estoppel) or fails to enforce its rights and remedies under the lease (e.g. a waiver).

I. PROMISSORY ESTOPPEL AND WAIVER

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A. Promissory Estoppel

The doctrine of promissory estoppel finds its roots in *Central London Property Trust Ltd. v. High Trees House Ltd.*, [1947] 1 K.B. 130, [1956] 1 All. E.R. 256 (K.B.). In that case a landlord and tenant entered into a 99 year lease at a rent of £2,500 per year. The lease was entered in 1937 and by 1940, with the outbreak of war, the tenant was unable to pay the stipulated rent. The landlord agreed, in writing, to an arrangement by which the rent was reduced to £1,250 per year. No duration of the reduction of rent was specified and there was no consideration given to the landlord. Lord Denning, then of the Kings Bench Division, wrote a judgment which explains the doctrine of what has become known as promissory estoppel. In cases where promises are made: (a) “which were intended to be binding”, (b) which the parties making them knew would be acted on” and (c) which the parties to whom they were made did act on” the court will hold the promise to be binding on the party making it, even though it was made without any consideration being given.

In *International Knitwear Architects Inc. v. Kabob Investments Ltd.* (1995), 49 R.P.R. (2d) 268 (B.C.C.A.), a commercial tenant began to experience financial difficulties two years into a five-year lease term. The tenant couldn’t afford to pay the rent and asked the landlord if it would agree to a rent reduction. The landlord “displaying a good natured wish to help his tenant through a difficult time” agreed to accept reduced rent. Even though the tenant did not give any fresh consideration for a rent reduction, the effect of the “arrangement” was to create a promissory estoppel which prevented the landlord from enforcing its right to recover the full rent stipulated by the lease. The Court of Appeal found that the estoppel continued until the landlord gave reasonable notice of its intention to revert back to the strict terms of the lease. Madam Justice Southin, writing the decision for the Court of Appeal, concluded that the landlord was entitled to give, and the tenant was obliged to accept, reasonable notice to revive the strict obligations of the lease: paragraph 29. In the circumstances of that case, the Court of Appeal concluded that a reasonable time to revive the full rent obligation was five weeks’ notice.

B. Waiver

II. RENT REDUCTION AND ABATEMENT AGREEMENTS

Rent reduction and abatement agreements are usually only considered by landlords of shopping centres where the appearance of a fully occupied centre is important, the traffic generated by one tenant is of benefit to other tenants in the centre and the number of customers attracted to the centre has a direct impact on the amount of percentage rent the landlord collects from all tenants. In extreme situations, rent reduction and abatement agreements provide a landlord with the ability to recover its expenses for property

taxes and operating costs for the centre even though the landlord may have to accept a lower return on its investment in the form of reduced base rent or minimum rent.

If a landlord is prepared to consider a rent reduction and abatement agreement, then it should always be reduced to writing. While the specific terms and conditions will vary from one agreement to the next, some of the points a landlord and tenant should consider, in negotiating a rent reduction and abatement agreement, include the following:

(a) For what period of time will the agreement remain in effect? A clear start date should be indicated. The end date should be the earlier of a fixed date, the date the lease expires or the date the landlord chooses to exercise a right to terminate.

(b) Is rent going to be abated or simply deferred? Some landlords will only agree to defer rent so the deferred rent can be claimed if the tenant defaults or if another creditor takes action against the tenant.

(c) Will the abatement or deferment only apply to basic or minimum rent? A landlord should ensure that there is no reduction or abatement in additional rent to cover the out-of-pocket expenses the landlord incurs to operate the centre.

(d) Will all the landlord's default remedies under the Lease be preserved? If the tenant fails to pay the reduced minimum rent, or any of the additional rent, then the landlord should be entitled to exercise any of its rights and remedies at law, under the lease and under the specific rent reduction and abatement agreement.

(e) Will the landlord require an express right to terminate the agreement? If the tenant fails to pay the reduced rent or discloses its rent reduction and abatement agreement to any other tenant of the centre, or if a better tenant comes along, then the landlord may insist upon the right to terminate the agreement. The agreement should also contain a provision that it be automatically terminated in the event of an assignment, sublease, sale of the tenant's business or a change in control of the tenant.

(f) Will the landlord want a right to recapture abated or deferred rent? Some landlords may want a right to recapture abated or deferred rent in certain circumstances (e.g. if the tenant breaches the confidentiality and non-disclosure provision or if another creditor takes steps to recover amounts due by the tenant).

(g) Is the agreement transferable? The agreement should make clear that the concessions granted are personal to the tenant and may not be transferred to the tenant's successors or assigns.

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(h) Is the tenant currently in default? As a precondition to the agreement, the tenant should be required to pay any rent which is currently in arrears.

(i) Does the landlord need the approval of its lender? If the landlord obtained financing on the strength of the rent income in the lease, the landlord may need the consent of its lender to reduce the rent.

(j) Are there any other modifications? The parties should acknowledge that, in all other respects, the terms and conditions of the lease continue in full force and effect.

III. SURRENDERS

IV. LANDLORD'S CONTROL AGREEMENTS AND DOWNSIZING

V. ASSIGNMENT, SUBLETTING AND CHANGE OF CONTROL

In the absence of an express prohibition in the lease, a tenant is entitled to sublet the premises for any period of time, less than the balance of its own lease term. If the lease is silent on the matter, then the tenant is entitled to grant a sublease without the landlord's consent: *Leith Properties v. Byrne*, [1983] 1 Q.B. 433 (C.A.).

More typically, however, the lease contains a covenant by the tenant not to sublet or assign without the prior written consent of the landlord (e.g. see covenants #11 and 12 in Schedule 4 to the *Land Transfer Form Act*). A tenant will typically try to qualify the covenant by including words stipulating that the landlord's consent can't be unreasonably withheld. It is not uncommon, however, to see words permitting the landlord to withhold consent, in its absolute discretion. The landlord ideally wants to retain absolute control on the choice of tenants for the landlord's property. The tenant, on the other hand, needs to retain flexibility to sell its business. This struggle between contrary positions will typically be won by the party with the stronger bargaining position.

The exact wording of the covenant will be examined closely, and will be construed strictly against the landlord to ensure that the landlord's power to restrain the tenant's commercial activity does not exceed the express provision of the covenant: *Groves v. Portal,* [1902] 1 Ch. 727. For example, in *Zurich Canadian Holdings Limited v. Questar Exploration Inc.* (1999), 171 D.L.R. (4th) 457 (Alta. C.A.) an amalgamation of the tenant with another company was held not to have created an assignment requiring the landlord's consent.

Where an unauthorized sublease is alleged, it is often possible to characterize the agreement in question as a mere licence. For example, a management contract entered into by a tenant and a third party, governing the business carried on in the leased premises, was held not to constitute a sublease in *389079 B.C. Ltd. v.*

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Coast Hotels Ltd. (1998), 63 B.C.L.R. (3d) 359 (B.C.S.C.). In order for there to be a sublease as opposed to a mere licence, the contract must create an interest or an estate in land, there must be a right to exclusive possession (though exclusive possession is not necessarily decisive), and the intention of the parties and the substance of the contract must clearly indicate that an interest in the premises has been granted: *Lippman v. Yick*, [1953] 3 D.L.R. 527 (Ont. H.C.), cited in *389079 B.C. Ltd. v. Coast Hotels* (supra).

A. When May a Landlord Arbitrarily Refuse Consent, and When Must a Landlord Act Reasonably?

Unless there is a positive covenant on the tenant's part to refrain from subletting the premises or assigning the lease, the tenant may do so without the landlord's consent. Any devise of an interest in land carries with it the right to dispose of the interest, subject to the nature of the grant: *Williams & Rhodes, Canadian Law of Landlord and Tenant, 6th ed.* (Vancouver: Carswell, 1988).

It is open to the landlord to refuse consent arbitrarily or unreasonably if the covenant so provides. It is not clear whether a court will imply a term requiring the landlord to act reasonably where the provision is silent as to the circumstances in which the consent may be withheld. The principles of law governing implied terms are found in *Luxor (Eastborne) Ltd*. v. *Cooper,* [1941] A.C. 108, [1941] 1 All. E.R. 33 (H.L.). Generally speaking, terms will only be implied when necessary to give such business efficacy to the agreement as the parties must have intended.

The question of whether a landlord's refusal to consent to an assignment or sublease is unreasonable is a question of fact to be determined on the evidence in each case, and case law on this point does not suggest any single factor that will determine what is reasonable. The test to be applied in determining whether consent has been unreasonably withheld is an objective test; would a reasonable person in the circumstances of the landlord have refused to consent to the assignment, considering the surrounding circumstances, the commercial realities of the marketplace and the economic impact of the assignment on the landlord: *Federal Business Development Bank v. Starr* (1986), 28 D.L.R. (4th) 582 (Ont. H.C.); cited by the British Columbia Court of Appeal in *Lehndorff Canadian Pension Properties Ltd. v. Davis Management Ltd.* (1987), 13 B.C.L.R. (2d) 367 (B.C.S.C.).

Prior to the evolution of this "reasonable person" standard, the common law relating to reasonableness of the landlord centred on a two-part test: first, whether the refusal is grounded upon the character of the proposed assignee or subtenant, and second, whether the nature of the use or occupation of the premises provided grounds for refusal: *Houlder Brothers & Co. v. Gibbs,* [1925] Ch. 575 (C.A.).

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In *Viscount Tredegar v. Harwood,* [1929] A.C. 72, (H.L) acting reasonably was distinguished from acting "justly, fairly, or kindly". The court said reasonableness was to be construed with reference to the "consideration of the motives of convenience and interest" which affect the landlord "not those which affect somebody else".

The watershed case on this issue is *Premier Confectionery (London) Company Limited v. London Commercial Sales Rooms Limited,* [1933] Ch. 904 (Ch.). In that case, one tenant leased two separate tobacconist's shops. So long as one tenant ran both businesses, they did not compete with each other. The landlord refused to consent to the assignment of one of the leases by the tenant to a third party. While the landlord's refusal was not related to the character or financial circumstances of the assignee the court considered that the use to which the premises were to be put was undesirable in that it would create competition between two tenants of the property. The landlord was entitled to object to an assignment of one lease even though the proposed use was not forbidden by the terms of the lease.

In Canada, reluctance to adopt the restrictive two part test in *Houlder Brothers* (supra) was first voiced in the Ontario Court of Appeal decision in *Shields v. Dickler,* [1948] 1 D.L.R. 809 (Ont. C.A.).

More recent case law tends to follow the formulation of Lord Denning in *Bickel v. Duke of Westminster,* [1977] 1 Q.B. 517 (C.A.) where he concluded that the previous case law did not "lay down any propositions of law" and stated:

I do not think that the court can or should determine by strict rules the grounds by which the landlord may or may not reasonably refuse his consent. He is not limited by the contract to any particular grounds, nor should the courts limit him. Not even under the guise of construing the words. The landlord has to exercise his judgment in all sorts of circumstances. It is impossible for him, or the courts, to envisage them all … (The) circumstances are infinitely various it is impossible to formulate strict rules as to how a landlord could exercise his power of refusal. The utmost that courts can do is to give guidance to those who have to consider the problem.… The reasons given by the judges are to treated as propositions of good sense – in relation to the particular case – rather than propositions of law applicable to all cases.… All that can be properly done is to indicate the chief considerations which help to arrive at a just conclusion.

This echoed his earlier comments in *Wilson N. v. Fynn,* [1948] 2 All. E.R. 40 (K.B.):

I do not think it is necessary to lay down specific grounds whether conduct is reasonable or unreasonable. The circumstances of each case must be considered and in considering that point, I am not confined to the evidence with regard to the construction of the lease, but am entitled to have regard to the understanding that was contemplated by the parties when the lease was instituted.

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The Ontario Court of Appeal in *Re Griff et al and Sommerset Management Services Ltd. (1978),* 84 D.L.R. (3d) 386, (Ont. C.A.) referred to Lord Denning's approach in *Duke of Westminster v. Bickle* (supra) as the "high-water mark in this area of the law".

That said, there remains the occasional case which links reasonableness between the landlord's grounds for refusal to specific provisions of the lease. For example, in *Canada Safeway Ltd. v. Triangle Acceptance Limited,* [1980] 3 W.W.R. 352 (Man. Co. Ct.), a landlord refused a sublease to a subtenant operating essentially the same business as the tenant on the grounds that there was a risk of a lower volume of shoppers which would have an impact on the other tenants of the landlord's premises. As there was nothing in the lease respecting a commitment to a volume of shoppers, Philp C.J. held that the landlord's refusal was unreasonable.

Reasonable refusals have included:

- where the landlord considered that the proposed sublease was calculated to depreciate the value of the property and would have detracted from the landlord's negotiations for a subsequent sale or mortgage of the property: *Re Town Investments Limited Underlease; McLaughlin v. Town Investments Limited,* [1954] 1 All. E.R. 585 (C.D.).
- where the proposed use of the premises by the subtenant or assignee conflicts with the user clause in the lease: *Re Acklands Leasehold Properties Limited v. Stehild Investments Limited* (1981), 127 D.L.R. (3d) 646 (Ont. C.A.).
- where the assignee or subtenant's proposed use would conflict with the landlord's covenants to his other tenants: *Ayre's Limited v. Atlantic Shopping Centres Ltd.* (1989), 62 D.L.R. (4th) 12 (Nfld. C.A.).
- where the original tenant was to be an anchor tenant, and the proposed subtenant would not be considered an anchor tenant: *New Miracle Food Mart Inc. v. General Leasehold Ltd.* [1993], O.J. No. 1293 (Ont. Gen. Div.).
- where the subtenants are in possession of the premises prior to consent being obtained: *Pink Panther Food Corp. v. N.D. McLellan Ltd.* (1988), 75 O.R. (2d) 651 (Ont. Dist. Ct.).

It is reasonable for a landlord to withhold consent until damages to the leased premises are repaired. *F.B.D.B. v. Starr* [supra]. It is also reasonable for a landlord to withhold consent pending the receipt of financial information on the assignee or subtenant, as the landlord is entitled to make an informed judgment and to be satisfied that the assignment or sublease would not result in the premises being used or occupied in an undesirable way: *Moore v. New Progress Construction Ltd.* (1980), 9 Man. R. (2d) 434 (Man. Co. Ct.).

The landlord's lack of objection to the transfer does not amount to consent. The landlord must also be given

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reasonable time in which to consider the request.

Withholding of consent has been found to be unreasonable in the following circumstances:

- where the landlord is merely attempting to obtain a higher rent for the premises: *Dominion Stores Limited v. Bramalea Limited* (1985), 38 R.P.R. 12 (Ont. Dist. Ct.).
- where the landlord is attempting to obtain further commercial benefit and advantage from the lease such as further and better security: *St. Jane Plaza Limited v. Sunoco Inc.* (1992), 24 R.P.R. (2d) 161 (Ont. Gen. Div.).
- where the tenant remains liable under the covenants, the assignee's financial condition will not provide grounds for reasonable refusal of consent *Lehndorff* (supra).
- where a landlord based his refusal on the risk of a lower volume of shoppers which would have an impact on the other tenants of the landlord's premises, and there was no commitment by the tenant in the lease to a volume of shoppers: *Canada Safeway Limited v. Triangle Acceptance Limited* (supra).

Where a landlord is aware of the assignment or sublease and continues to take rent payments from the assignee or subtenant, the landlord's action may amount to a waiver of the breach of covenant. This may extend to other actions of the landlord: *Mascan Corp. v. 27813 Ontario Ltd.* (1984), 3 O.A.C. 225 (C.A.).

Where the landlord gives a consent to a sublease, the subtenant is not bound by the tenant's covenant not to assign or sublease and a further sublease will not amount to a breach of the covenant not to sublease: *Royal Trust Co. v. Bell* (1909), 12 W.L.R. 546 (Alta. T.D.).

What is the burden of proof in showing unreasonableness? In *Coopers and Lybrand Ltd. v. William Schwartz Construction Co.* (1980), 116 D.L.R. (3d) 450 (Alta. Q.B.), the tenant who leased premises in a shopping centre went into receivership. When the landlord refused to consent to an assignment, the receiver challenged that decision. The court held that the onus was on the receiver to establish that the withholding of consent to the assignment was unreasonable. In that case the subtenant's business was not identical to that of the tenant and the landlord withheld his consent because the business of the subtenant was likely to affect the business of other tenants in the shopping centre. The landlord was entitled to consider the impact of the subtenancy on the other tenants and the court concluded that the receiver failed to establish that the landlord withheld his consent unreasonably.

B. What is a Tenant's Remedy When a Landlord Unreasonably Refuses Consent?

Historically, the covenant not to assign without the reasonable consent of the landlord has been construed

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as a tenant's covenant qualified by an obligation on the landlord to act reasonably. The traditional remedy granted was limited to declaratory relief; the covenant became inoperative, the tenant was released from the obligation not to assign if the consent was unreasonably withheld and was given an equitable right to the assignment or sublease. The tenant's course of action, therefore, was not to sue the landlord but rather, once the landlord unreasonably refused to consent, the tenant was free to simply go ahead with the assignment or sublease.

Historically, the unreasonable withholding of consent to assignment did not give the tenant a right of action or a right to damages but merely allowed the tenant to assign or sublease without consent: *Treloar v. Bigge* (1874) L.R. 9 Ex. 151. However, the modern conception of a lease is that it is as much a contract as a conveyance, and the full range of contract remedies is available: *Highway Properties Ltd. v. Kelly, Douglas and Co.* [1971] S.C.R. 562 (S.C.C.), *Cudmore v. Petro Canada Inc.,* [1986] 2 B.C.L.R. (2d) 113 (B.C.S.C.). In *Lehndorff Canadian Pension Properties Limited v. Davis Management Limited* (supra), a landlord's unreasonable withholding of consent to a sublease was held to be a fundamental breach of the lease by the landlord giving rise to an election by the tenant to either treat the breach as a termination of the contract or affirm the contract and sue for damages: *Morrison-Knudsen v. British Columbia Hydro and Power Authority*, (1978) 85 D.L.R. (3d) 186 (B.C.C.A.).

The tenant, if he believes that consent is being unreasonably withheld, may proceed with the assignment or sublease and seek a declaration from the court that consent is unreasonably withheld. However, this involves significant risk to the tenant as failure to obtain the declaration may be considered a forfeiture of the lease.

It does not appear that withholding consent unreasonably constitutes constructive eviction of the tenant: *Lehndorff Canadian Pension Properties Limited v. Davis Management Limited* (supra).

Assignment or sublease by the tenant made without requesting leave will be a breach of a covenant such that it causes a forfeiture of the lease, and the landlord may avail himself of the remedies available in that situation.

Where the tenant breaches the covenant not to assign, the measure of damages will be an amount that will put the landlord in the same position as if the tenant was still liable on the lease instead of the assignee or subtenant: *Williams v. Earle* (1868) L.R. 3 Q.B. (2d) 739. Where there is a flagrant breach of the covenant not to assign or sublet and there are damages to the premises by the assignee or subtenant, the tenant may be liable for those damages: *Lepla v. Rogers,* [1893] 1 Q.B. 31.

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