



ICSC LAW CONFERENCE, TORONTO, APRIL 2018  
**DECONSTRUCTING THE OPTION TO RENEW/EXTEND CLAUSE**

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### 1. DEFINITIONS AND DISTINCTIONS

**Option to Renew:** The original lease stops at the end and the renewal involves the creation of a new lease on the same terms as the original lease, other than as contemplated and, in theory, the following provisions take effect: vacating the premises, removal of trade fixtures, etc. A renewal is the re-creation of the legal relationship and the replacement of the old lease with a new lease.

**Option to Extend:** The original term of the lease is extended without interruption.

- *Buckerfields v Abbotsford Tractor and Equipment*, 2017 BCPC 185. - A court must determine, from a *consideration* of the language used, whether the parties intended to create a renewal or an extension. The distinction seems to be that a renewal replaces the old terms of occupancy with some new ones, while an extension changes nothing other than the length of time for the tenant's occupancy.

### 2. EFFECTS ON PERSONAL RIGHTS

**Option to Renew:** Clauses that are personal to the Tenant and the Landlord will not apply during the renewal, ie: Tenant - Right of First Refusal, Landlord – Radius Clause, Guarantees and indemnities, etc. These are separate agreements from the Lease and do not survive the end of the term of the Lease.

- *Yorkshire Trust Co. v. Gunter Farms Ltd. (1989)*, 40 B.C.L.R. (2d) 161 (C.A.) Although from 1989, this case has no negative treatment. At common law, a covenant to pay rent runs with the reversion, but a guarantee of such a covenant does not. The making of a court order does not of itself create any relationship of landlord and tenant; that relationship, by its very nature, is consensual. When the tenants paid rent to the receiver they became, by attornment, tenants of the receiver. But mere attornment does not create a new tenancy on the terms of the existing tenancy, nor does it give the receiver contractual rights against the guarantors. The root of the plaintiff's problem in this case was that it failed to get an assignment from A. Ltd. of A. Ltd.'s rights under the lease.

**Option to Extend:** Clauses that are personal to the Tenant will automatically be extended during the extended term.

#### Recommendations:

- Both the Landlord and the Tenant should insist on an Extension of the Term.
- If the Lease provides for a renewal, then any clauses that are important to either party, which that party may consider personal, should be expressly included in the renewal.
- *Avlor Investments Ltd. v. J. K. Children's Wear Inc. (1991)*, 85 D.L.R. (4<sup>th</sup>) 239 (Ont. Ct. (Gen. Div.)) Although from 1991, *this* case has no negative treatment. At common law, the privity of contract between the original landlord and tenant continues after an assignment of a lease. Where the assigned lease contains an option to renew and the option is exercised by the assignee, the general rule is that the exercise of the option will create a new lease and accordingly end the privity of contract between the original landlord and tenant. However, if the right given to the tenant is to extend the term of the original lease, then privity of contract between the original landlord and tenant will continue.

### 3. DUTY OF GOOD FAITH?

In the event the Tenant misses the date for exercising its option:

- **Is missing the deadline a fatal mistake? YES**
- *Zone Bowling Centre (2002) Ltd. v 14100 Entertainment Blvd. Investments Ltd.* 2015 BCSC 524 “there is no compulsion on the tenant to exercise the renewal option, but if it does, it must comply with the conditions precedent. If it fails to do so, it does not suffer the forfeiture of an existing tenancy, but loses its right to renew the tenancy”.
- *Don Francesco Restaurant (2013) Ltd. v Oxford Properties Group Inc.*, 2017 BCSC 1285 [option to renew vs. mandatory terms] “Existing options to renew are different from mandatory terms in a contract because neither party is obliged to insist on them. If party to a commercial contract wants to exercise an *option*, there must be strict compliance with the contractual terms thereof.”

- Does the Landlord owe a duty of good faith to the Tenant? NO
- Does the Landlord have a duty to remind the Tenant about the time to renew? NO

**Recommendations:** Options must be exercised in strict compliance or the Tenant may lose its right completely.

#### 4. WHAT IS FAIR MARKET RENT?

**General Definition:** The rent that would reasonably be obtained by a willing landlord for similar premises from a willing tenant dealing at arm's length in the prevailing market, for a term commencing on the relevant date and having regard to all relevant circumstances. As easy it may appear, agreeing on Fair Market Rent is not an easy task...

##### Value of Leasehold Improvements

Should the value of the Tenant's leasehold improvements be included in the determination of Fair Market Rent? Landlord can take the position that the value of the leasehold improvements should be included in the determination of Fair Market Rent because the Landlord can argue that he can charge more rent to a new tenant because of the leasehold improvement being already in place.

- *Revenue Properties Co. v. Victoria University (1993), 62 O.A.C. 351 (Div. Ct.)* – when calculating “fair market rent” the property must be examined in an “as was” condition, being the state of the premises prior to the addition of the leasehold improvements, rather than an “as is” condition. Making a tenant pay increased rent based on the inclusion of leasehold improvements made during the term of the lease would make the tenant pay rent upon a value created by the Tenant's own authorized expenditures and so diminish the worth of his leasehold estate.
- *Fire Production Ltd. v. Lauro [2007] 1 W.W.R. 605 (B.C.C.A.)* – this is a decision that is contrary to the one above discussed - In this case, the parties were unable to agree on fair market rent and the matter was referred to arbitration. Tenant had made improvements to the premises during the initial term for a restaurant business. The arbitrator pointed out that the lease provided that all improvements made by tenant became property of the landlord upon affixation. The arbitrator determined that the value of the leasehold improvements should be included in the determination of fair market rent. The B.C. Court of Appeal agreed, indicating that the term “market” is the rent the premises would attract if exposed to the general market at the time of the renewal. This definition precluded the exclusion of the tenant's improvements in calculating the rental rate for the renewal. The Court indicated that “fair rent” is a subjective determination between the parties as opposed to “fair market rent”, which is an objective determination based on market factors.

**Recommendations:** In order to avoid any issues, express language confirming whether the value of the leasehold improvements will be included in the calculation of fair market rent should be inserted in the lease. The landlord will want the value of the leasehold improvements included and the tenant will want it excluded, and therefore, you must remember to negotiate the language in favour of your client as much as possible.

##### Arbitration Clauses

##### **What if there is no arbitration clause in the option/renewal clause contained in the Lease?**

- *Mapleview-Veterans Drive Investments Inc. v. Papa Kerollus VI Inc. (c.o.b. Mr. Sub) [2015] O.J. Np. 3111 (Ontario Superior Court of Justice, June 12, 2015; [2016] O.J. No. 584 Ontario Court of Appeal, February 2, 2016, R.A.* - The lease contained a renewal option for a further period of 5 years. The lease stated the rent payable during the renewal term would be the “then current rate”. The tenant notified the landlord within the timeframe of its exercise of the renewal option. The landlord brought an application for an order that the tenant was in breach of the lease (*not discussed in this paper*) and a declaration that the renewal option was void for uncertainty. The landlord took the position that the renewal clause was merely an agreement to attempt to agree, particularly given that there was no arbitration clause or other fixed mechanism for determining the rent application for the renewal term. The landlord indicated that the law does not recognize a contract to enter into a contract, nor a contract to negotiate, and without specific guidelines for the calculation of rent or a provision for arbitration, and the option to renew is unenforceable. The tenant indicated that the lease stated that rent would be at the “then prevailing market rates” which has been held enforceable, and that if the parties were unable to agree on the applicable formula, the determination could be referred to the court. The Court distinguished the case law on which the landlord had relied from the present case, noting that in that case, the lease stated that the monthly rent would be determined by “agreement” between the parties. The Court held that the term “current rates” clearly indicated that the parties anticipated a renewal, and that the renewal rate would have legal effect. Though there was no arbitration clause, the parties were free to negotiate to determine the applicable rates failing which the parties could have resorted to a decision by arbitration or the courts. The Court held that the renewal clause was not void for uncertainty. The Court of Appeal upheld the lower court's finding, noting that the courts should try, wherever possible, to give the proper legal effect to any clause that the parties understood and intended was to have legal effect.