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MEDTAIL: LOOKING BOTH WAYS BEFORE CROSSING THE STREET TO MEDICAL LEASES

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When it comes to shopping malls, the one constant seems to be change. The journey from the rise of the enclosed shopping centre in the 1950s to the wide and varied centres that exist today has been one beset by constant challenges and today's landscape is no exception. E-commerce in particular has changed how customers shop, and shopping centres have adapted accordingly to offer experiences and a form of shopping different than what can be consumed online.

While the top tier malls have for the most part be able to weather the storm, some B and C class centres have not been as fortunate. The fall of department stores have left many mall owners scrambling to fill vacancies and find other tenants to both occupy space and drive traffic to their malls. The Covid-19 pandemic compounded these issues and hastened these changes. One somewhat unexpected solution that has begun to gain favour are medical tenants.

Medical centre – a centre comprised primarily of medical tenants - is far from new. Generally there is an easy form of synergy in a medical building. The tenants may comprise any number of doctors, a laboratories, pharmacies and other medical uses. A patient can see their doctor, have specimens taken, and fill their prescription all in one visit.

However, the newer trend being seen is the marriage of these medical uses within a traditional retail shopping centre. The rise of this new potential synergy has coined the phrase "medtail" or medical retail.

The attraction of medical tenants from a landlord's perspective is easy to see. Medical tenants, such as doctors, typically have higher credit ratings and may look to sign longer term leases. They are a captive audience as well; staff and employees are likely to shop in the centre, both during their breaks and as a matter of convenience. Of course one of the main draws of

medical tenants are the patients they bring in. From a landlord's perspective, a "patient" might as well be another word for "customer"! Finally by diversifying the tenant mix landlords can try to future proof its shopping centres, leasing space to tenants who may be able to operate in a pandemic or other challenging environment. When you contrast a medical use to other non-traditional uses that mall owners are exploring, such as parcel pickups that are unlikely to attract customers that linger, it is easy to see the appeal.

Likewise, shopping centres can be highly attractive to medical tenants. Shopping centres are often centrally located, with close access to highways and other transportation methods. They are also generally located within densely populated areas. Perhaps most importantly most shopping centres are designed with easy vehicle access and a large number of parking spots. Medical tenants may be willing to pay a premium in order to enjoy these benefits and have prime access and visibility.

However, with new opportunities come new challenges. Many of the traditional lease provisions in a shopping centre lease have been drafted taking into consideration only traditional retail uses. Large anchor tenants may negotiate prohibited shopping center uses which would prohibit some or all medical uses. The physical services used by a medical tenant may require certain base building upgrades, such as providing additional utilities or emergency backup generators for a critical medical use. In addition, medical tenants may require additional services beyond normal operating costs, such as hazardous waste removal. The hours of operation of a medical tenant might very well be different than a typical retail tenant. Co-tenancy provisions that are tied to retail uses pose its own particular set of challenges.

One of the biggest challenges to landlords in leasing space to medical tenants in a traditional retail shopping centre is managing and balancing permitted uses and exclusive rights.

This challenge arises both in ensuring that existing retail tenants' rights do not infringe upon or prohibit a proposed medical use, as well as carefully drafting the use and exclusive provisions amongst the proposed incoming medical tenants to ensure a lease to one medical tenant will not prohibit the landlord from leasing space to other medical tenants.

Broadly speaking, a landlord will want to ensure a use clause in lease is narrowly drafted to ensure that the tenant cannot carry on any other use other than the specifically negotiated use. A use clause that simply permits a tenant to carry on a use without limiting the tenant's use to *only* that use runs the risk as being seen as permissive but not restrictive. Conversely, the challenge for tenants is ensuring sufficient flexibility is built into the use to allow for future growth or change as the business evolves.

Pharmacies are a great example of this tension. The historical pharmacy use would have been limited to dispensing pharmaceutical products. Of course, anyone that has stepped into a Shoppers Drug Mart or Rexall recently knows that the product offerings are far more diverse than that. In fact, today, most brand name pharmacies generate well more than 50% of sales from the sale of non-pharmaceutical items.

The focus of this paper is a look back at a trilogy of cases spanning the late 1980s through the early 2000s involving supermarkets and pharmacies as both business evolved. In looking forward and exploring the new benefit of medtail, both landlords and tenants would be well served to keep an eye on the past and avoid the potential pitfalls these case illustrate.

LONDON DRUGS LTD. v. TRUSCAN REALTY LTD. et al.[1]

Facts

In 1979, London Drugs Ltd. ("London Drugs") entered into a lease with the owner of a shopping centre known as Spall Plaza in Kelowna, British Columbia. The London Drugs lease included a restrictive covenant that the landlord would not lease any part of the shopping centre for the purpose of carrying on the business of selling prescription drugs or prescription eye glasses.

In 1985, the landlord entered into a lease with Pattison Industries Ltd. to operate a food supermarket. The supermarket operated under the trade name "Overwaitea Food and Drugs" ("Overwaitea"). The use clause in the Overwaitea lease stated the following:

> **4.01 Conduct of Business**
>
> The Tenant shall not use or occupy or permit the use or occupation of the Leased Premises or any part thereof for any purpose other than the operation of a food supermarket. The Tenant shall operate its business in the Leased Premises under the name 'Overwaitea Foods', 'Save-On-Foods' or such other name as it considers appropriate.

When the Overwaitea store opened later that year, it contained a pharmacy. The landlord wrote to Overwaitea advising that the use of a food supermarket precluded the operation of a dispensary selling prescription pharmaceuticals and advised of the restrictive covenant which had been granted to London Drugs. Not surprisingly, Overwaitea disagreed with the landlord's interpretation of the use clause and pointed out that an examination of title of the shopping centre lands had indicated no restrictive covenants of any kind had been registered, and that no notice had been given to Overwaitea of any restrictive covenants. Overwaitea refused to agree to the

[1] *London Drugs Ltd. v. Truscan Realty Ltd. et al.*, 1988 CarswellBC 646, [1988] B.C.W.L.D. 2743, [1988] C.L.D. 1483, [1988] B.C.J. No. 1366, 11 A.C.W.S. (3d) 41, 3 R.P.R. (2d) 60

landlord's request to cease operating the pharmacy. Thereafter London Drugs commenced legal proceedings, including for an interim injunction restraining Overwaitea from operating a pharmacy.

Decision

A number of issues were brought up in the proceedings, including whether the covenant was personal or ran with the lands, and whether the London Drugs had standing to claim against Overwaitea. The primary issue for the purpose of this paper is whether the Overwaitea use provision prohibited Overwaitea from operating a pharmacy. The Court noted that the Overwaitea use clause was drafted to be restrictive. Overwaitea was not permitted to use or occupy the premises for any purpose *other than* the operation of a food supermarket. The question therefore became what is meant by a "food supermarket".

Overwaitea argued that a "food supermarket" meant a store whose primary emphasis is on food and food-related products. Moreover Overwaitea took the position that "food supermarket" was to be read expansively, particularly given the lease was for a term of 20 years with options to renew for up to another 20 years.

However the Court noted that the words to be interpreted in accordance with their plain, ordinary and popular meaning. Overwaitea had bargained for the use of a "food supermarket" being not just any supermarket, but a supermarket limited to the selling of food. As of the date of execution of the Overwaitea lease, supermarkets in British Columbia did not include in-store pharmacies. In addition, as of the date the Overwaitea lease was entered into, Overwaitea was in fact not permitted by law to carry on the business of a pharmacy. In order to comply with the provisions of the *Pharmacist Act,* R.S.B.C. 1979, subsequent to the lease execution Overwaitea

appointed a pharmacist as a director of the company so that Overwaitea could obtain a pharmacy license. The Court drew the inference that at the time of execution Overwaitea did not intend to operate a pharmacy in the premises.

Accordingly, the court found that as the use clause only permitted a "food supermarket" the operation of a pharmacy was restricted, and Overwaitea was found to be in breach of its lease.

Appeal

The trial judge's interpretation of Overwaitea's use clause was appealed.[2] The appellate court was asked to interpret the use clause having regard to the fact the lease was 20 years in duration with up to a further 20 years in option terms, so that the words "food supermarket" would be interpreted in light of the conditions as they existed from time to time. In other words, even were a pharmacy use not part of a food supermarket in 1985, if it became part of such use in the future then that use should be permitted under the Lease. The appellate court noted that such an interpretation did "not rest sufficiently firmly in the wording of the cause" and contrasted the Overwaitea lease with the London Drugs lease, where the use clause in fact specifically contemplated "all other items normally carried in other London Drug outlets from time to time". *[emphasis added]* While the London Drugs lease clearly contemplated a change in the use, the Overwaitea lease did not. The appellate court ultimately found there was no error in the reasons of the trial judge and dismissed the appeal.

[2] 1989 CarswellBC 1322, [1989] B.C.W.L.D. 1392, [1989] C.L.D. 747, [1989] B.C.J. No. 823, 15 A.C.W.S. (3d) 145

CADILLAC FAIRVIEW CORPORATION LIMITED v. CANADA SAFEWAY LIMITED[3]

Facts

On April 1, 1981, Canada Safeway Limited ("Safeway") entered into a lease for premises in Tillicum Mall, in Victoria, British Columbia. A short few weeks prior to the Safeway lease, the landlord had entered into a lease with Boots Drug Store (Western) Ltd ("Boots"). In 1988, Boots assigned its lease to Shopper Drug Mart ("Shoppers").

In 1989, Safeway opened a pharmacy department in its store. Both the landlord and Shoppers took the position that Safeway was not entitled to operate a pharmacy department. The relevant lease provisions from the Safeway lease were as follows:

> 13. Assignment and Subletting — Lessee may with the consent of the lessor, assign this lease or sublet or otherwise part with possession of all of the leased premises to any person, firm or corporation provided that the business to be conducted from the leased premises is the Approved Business as hereinafter defined. ...
>
> 'Approved Business' means the retail sale of supermarket goods and services with at least forty (40%) of the product and services being food for off-premises consumption. *[emphasis added]*
>
> If, after the 10th year of operation (as provided in Paragraph 31) the Lessee is not open for business in the leased premises for a period in excess of one year, provided 6 months prior written notice is given to lessor, except for remodelling and force majeure (as defined in Paragraph 32 hereinafter) the Lessor:
>
> (a) has the right to terminate the lease or
>
> (b) has the right to terminate the four separate and additional option periods.
>
> The foregoing right to terminate shall expire unless exercised within 180 days after expiration of the one year period.

and:

> 31. Covenant to Operate — So long as T. Eaton Company Limited and Zellers Limited, (or assignee acceptable to lessee) *both* remain open for business in the Shopping centre,

[3] *Cadillac Fairview Corporation Limited v. Canada Safeway Limited*, 1991 CarswellBC 682, [1991] B.C.W.L.D. 1903, 19 R.P.R. (2d) 250, 27 A.C.W.S. (3d) 1238

> the Lessee covenants that, subject to the provisions of Paragraph 13 hereof, it will not during the first ten (10) years of the term of this release vacate the leased premises unless prohibited by force majeure (as defined in paragraph 33 hereinafter) or remodelling for a reasonable period, either in whole or in part (whether actually or constructively), but will:
>
> (1) conduct its approved business (as defined in paragraph 13 hereof) in the entire leased premises.
>
> (2) remain open for business at least during such store hours as are observed by it in a majority of its other retail supermarkets within 10 miles of the leased premises or at least forty (40) hours per week except:
>
> (a) when prohibited by law, or
>
> (b) when T. Eaton Company Limited or Zellers Limited are closed for business for reasons other than force majeure (as defined hereinafter in paragraph 33).
>
> (3) actively carry on in the leased premises the type of business for which the leased premises are leased to the lessee.

Decision

The Court began by noting a similar situation had arisen in the *London Drugs*[4] case. After summarizing the findings in the *London Drugs* decision, including the appeal, the Court pointed out that the Overwaitea lease contained a use clause which was limited to a "*food* supermarket". However in the Safeway lease the reference was to the "approved business" which was defined to mean the retail sale of supermarket goods and services with at least 40 percent of the product and services being food for off-premises consumption. The Court also pointed out that the first reference to "approved business" appeared in the provision dealing with assignment and subletting.

The Court went on to state that while the Overwaitea lease was read as being restricted to a *food* supermarket, a general supermarket would have a much broader use. In addition, the

[4] *Supra,* note 1.

Safeway use clause included a specific restriction requiring at least 40 percent of the products and services as food for off-premises consumption.

In reading the lease in its totality, the Court considered that the "approved business" was contemplated both in the context of assignment and subletting, and in the obligation to remain open for the first 10 years of the Lease. The Court therefore interpreted the clause as being permissive. In other words, the usage of "approved business" inherently contemplated a change of use over time, which may occur by reason of an assignment or sublease, all of which would be permitted so long as it would be consistent with an overall supermarket use and at least 40 percent of such use devoted to the sale of food products for consumption off the premises.

While the appellate court in *London Drugs* was not willing to step in and interpret the lease in the context of changing over time, that decision was based on the specific narrow and restrictive wording in the Overwaitea lease. In this instance, where the only use restriction expressed in the Lease was requiring 40 percent of the use for the sale of food products, the Court concluded the intent was to allow a broader supermarket use. Therefore a change in the character of the business over time would be permitted, as long as such evolved use was consistent with a supermarket use and the requirement to ensure that at least 40 percent of such use devoted to the sale of food products for consumption off the premises was satisfied.

NORSYD INVESTMENTS INC. (RECEIVER OF) v. SOBEYS GROUP INC.[5]

Facts

In 1979, Sobeys Group Inc. ("Sobeys") entered into a lease for premises in the North Syndey mall in North Sydney, Nova Scotia. The Sobeys lease included a use clause which provided as follows:

> Save as provided herein, the Lessee shall use the Leased Premises only for the purposes of the business of the retail sale of a complete line of food products, as well as general retail merchandising, as carried on by the rest of the majority of its stores.

In 1980, about a year after the Sobeys lease, the landlord entered into a lease with Shoppers Drug Mart ("Shoppers"). The lease included a restrictive covenant in favours of Shoppers whereby the landlord agreed not to permit any other premises to be used as a drug store, dispensary and pharmacy, or for the retail sale of items requiring the supervision of a registered pharmacist.

In October 2022, Sobeys began constructing a pharmacy in its premises. Shoppers contested Sobeys' right to operate a pharmacy, and eventually sued Sobeys.

Decision

Sobeys' right to operate a pharmacy turned on whether its use clause was broad enough to permit the operation of a pharmacy. Before interpreting the Sobeys use clause, the Court referred

[5] *Norsyd Investments Inc. (Receiver of) v. Sobeys Group Inc.*, 2003 CarswellNS 99, 2003 NSSC 62, [2003] N.S.J. No. 94, 121 A.C.W.S. (3d) 346, 213 N.S.R. (2d) 273, 42 C.P.C. (5th) 124, 667 A.P.R. 273

to Justice Iacobucci's general principles of contractual interpretation from *Manulife Bank of Canada*[6] and *Eli Lilly*[7], and quoted the following passage:

> Even apart from the doctrine of contra proferentem as it may be applied in the construction of contracts, the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation which promotes a sensible commercial result.

The issue could essentially be distilled to two questions.

(1) Is the operation of a pharmacy "general retail merchandising"?

(2) Is the operation of a pharmacy carried on by the rest of the majority of Sobeys stores?

After hearing conflicting expert evidence on the meaning of "general retail merchandising" the Court found that general retail merchandising usually means the business of selling merchandise in great variety, as in a department store or a general store. Therefore the business contemplated by the lease was the retail selling of a complete line of food products together with merchandise one might expect in a department store or a general store. However while the term includes the retail sale of a wide range of *goods*, the Court found it did not include the sale of *services* except

[6] *Manulife Bank of Canada v. Conlin*, 1996 CarswellOnt 3941, 1996 CarswellOnt 3942, [1996] 3 S.C.R. 415, [1996] S.C.J. No. 101, 139 D.L.R. (4th) 426, 203 N.R. 81, 30 B.L.R. (2d) 1, 30 O.R. (3d) 577 (note), 66 A.C.W.S. (3d) 555, 6 R.P.R. (3d) 1, 94 O.A.C. 161, J.E. 96-2122

[7] *Eli Lilly & Co. v. Novopharm Ltd*., 1998 CarswellNat 1061, 1998 CarswellNat 1062, [1998] 2 S.C.R. 129, [1998] A.C.S. No. 59, [1998] S.C.J. No. 59, 152 F.T.R. 160 (note), 161 D.L.R. (4th) 1, 227 N.R. 201, 80 C.P.R. (3d) 321, 80 A.C.W.S. (3d) 871, J.E. 98-1562

as necessary to effect the sale of goods. The question therefore became whether the operation of a pharmacy was the sale of pharmaceutical products or pharmaceutical services.

The Court noted that the operation of a pharmacy is a regulated *service*, not a regulated good. While prescription drugs and other pharmaceutical products are sold from the store, a pharmacy cannot exist unless operated by a professional pharmacist. As stated by the Court, "It is the pharmacist who makes the pharmacy a pharmacy". Accordingly the Court found the prominence of professional services at a pharmacy took it out of the general phrase "general retail merchandising".

In turning its mind to answering whether a pharmacy use was carried on from a majority of Sobeys' store, the Court considered what time frame was to be examined. Given the length of time that the lease was intended to cover, the Court inferred that the parties must have recognized that Sobeys' business would evolve during that time frame. The Court acknowledged that while including a phrase such as from "time to time" would have been helpful to interpret the elasticity in the use clause, the absence of such a phrase was not fatal as the elasticity was inherent in the nature of the business. Accordingly the Court concluded that the time frame contemplated by the use clause is the time a new use is introduced (or discontinued), rather than the time the lease was executed.

While the Court's finding that a pharmacy use was not covered by the phrase "general retail merchandising" was determinative of the matter, it also found that at the time of the proposed use less than a majority of all Sobeys stores included a pharmacy. Accordingly it was found that the operation of a pharmacy by Sobeys was a breach of Sobeys lease.

Conclusion

At first blush, the results from this trilogy of cases do not appear to be consistent. In *London Drugs* the court refused to interpret the use provision in the context of its current or evolving use. However in both the *Canada Safeway* and *Sobeys* decisions, the court showed a willingness to consider meaning of use provision at the time the use was introduced. In fact *London Drugs* specifically pointed to the lack of wording such as "from time to time" as being indicative of the parties' intent not allow for a flexible interpretation, whereas in *Sobeys* the court noted such wording was not necessary.

However, as is usually the case, it comes down the facts themselves and the specific wording of the case. In *London Drugs* Overwaitea limited itself to operating a food supermarket, or a supermarket serving food – to the exclusion of other items not consistent with a food supermarket[8]. In that context, additional language would have been necessary to evidence an intent to sell items *other* than sold by a food supermarket. While the meaning and business of a supermarket may in fact evolve over time, the limitation to the operation of a food supermarket remained. Ironically, the fact that Overwaitea branded itself Overwaitea Food and Drugs is a damning statement in of itself that the drug portion is something fundamentally different than food.

There are a number of takeaways for both Landlord and Tenants:

- From a tenant's perspective, in drafting use clauses, be very clear and expansive in terms of what can be done. Don't assume a general industry term will encompass something other than the core business, particularly if it is an evolving use. Future proof

[8] The appellate court commented that obviously it eludes common sense to think that a food supermarket would be confined only to food items. There would be a plethora of non-food items sold in a food supermarket – dishes, paper towels and the like – but it would have had to be consistent with the operation of a food supermarket.

your use clauses by ensuring that use takes into consideration what may be carried on "from time to time". Be cautious in tying in types of uses carried on in a majority of other stores, ensure there is a proper apples to apples comparison, such as operating under the same trade name within the same province.

- From a landlord's perspective, ensure the use clause is drafted narrowly. While the use clause can very well be restrictive, consider also adding prohibited uses. Some landlords attach actual exclusives to the lease which the tenant may abide by. Another approach can be to identify core uses being carried on by other current or prospective tenants and specifically prohibit that use.
- While it may be trite to say, when granting an exclusive right or restrictive covenant, ensure that all existing leases are excluded. You may think an existing tenant cannot carry on a use which is promised as exclusive to another tenant, but if you are incorrect, the results can be disastrous.

As always, draft carefully and concisely, keeping in mind that when a clause is interpreted at a later date, it will generally be by different people, with an understanding of different facts, in a backdrop or context that may very well look nothing like the state of affairs when the Lease was negotiated.