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Shopping Center Legal Update

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In Depth

Credit Tenants Get Wise to SNDAs

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Lenders love the financial strength of creditworthy national and regional chain stores or, as they are called, *credit tenants.* However, they often find problematic many of the favorable lease provisions that such tenants, because of their financial strength, are able to negotiate. Although leases with credit tenants are the best assurance that loans will be repaid, borrower defaults cannot be ruled out.

Therefore, shopping center owners seeking to finance or refinance their centers regularly ask credit tenants to sign Subordination, Nondisturbance & Attornment Agreements ("SNDAs") for the benefit of their lenders. In fact, securing SNDAs from credit tenants is routinely a contingency to the funding of a commercial real estate loan.

Terms of the SNDA

Understandably, a lender wants to be sure, if it has to resort to foreclosure, that the proceeds from the sale of the shopping center are first applied to the repayment of its loan. Therefore, lenders require that the lien of the mortgage or deed of trust on a shopping center have priority over all other liens. Additionally, lenders insist upon priority over existing and future leases.

Under an SNDA, a lease entered into after a loan is made is deemed to be junior in priority to the loan (i.e., a junior lease).[1] Correspondingly, a lease already in existence at the time of the loan has priority over the loan, but it likewise can become a junior lease if the tenant agrees to the priority of its lease being subordinated to the loan.[2]

That, of course, is one of the intended effects of an SNDA. A junior lease, like a junior lien, can be "wiped out" (i.e., become unenforceable) as a result of the foreclosure of a senior lien.[3]

In the case of a junior lease, the tenant can lose its lease as a result of a foreclosure—even if it wants to remain in possession under the terms of its lease and is willing to continue paying rent after the foreclosure. The new landlord (the *foreclosure purchaser*) is also in jeopardy if a creditworthy or other valuable tenant exercises its right as a "wiped-out" tenant to vacate the premises with no further obligation to pay rent.[4]

For a lender, it is not enough simply to rely upon attornment provisions in a lease that obligate the tenant to be bound to a foreclosure purchaser. The enforceability of automatic attornment provisions in leases varies from state to state. Instead, lenders generally want an agreement directly with the tenant, via an SNDA, before they will make the loan to the landlord.

In a typical SNDA, the tenant agrees to subordinate the priority of its lease to the lender's loan. The tenant also agrees that in the event of a foreclosure by the lender, it will attorn to the foreclosure purchaser (i.e., become contractually bound to the foreclosure purchaser under all terms of the lease) and, especially, continue satisfying all of the tenant's financial obligations under the lease.[5]

In exchange, the lender agrees that the foreclosure purchaser will not disturb the tenant's right to possession of the premises—even if the lease has by virtue of the SNDA been rendered junior to the loan—so long as the tenant is not in default under the terms of the lease.[6]

Lender-Drafted vs. Tenant-Drafted

In some lender-drafted SNDAs, however, attornment is applied in only one direction: The foreclosure purchaser is not required to assume all of the landlord's obligations under the lease, even if the tenant pays the rent and otherwise complies with all of its obligations under the lease.

In other lenders' forms, the foreclosure purchaser may be required to attorn to the tenant, but only if certain landlord obligations are waived in the event of a foreclosure. Usually, the lender's form will provide that certain new provisions, for the benefit of the lender and the foreclosure purchaser, be deemed added to the lease.[7]

The conflict arises when the lender wants the tenant to continue to comply with all of its lease obligations, without exception; but, the lender is reluctant for a foreclosure purchaser to be similarly obligated, particularly if landlord obligations require a foreclosure purchaser to spend money. For example, the lender would rather shift from the foreclosure purchaser to the tenant the burden of curing the delinquent landlord's failure to maintain the lender's collateral properly.

Use of an SNDA to alter indirectly the terms of a lease is what lenders' representatives call *cleaning up the lease*—as if provisions favorable to the highly desirable credit tenant will somehow besmirch the pristine character of the lease. Ideally, lenders want the tenant's signature on an SNDA to

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transform the lease into a "bond lease," as it relates to any foreclosure purchaser. If the lenders had their way, the foreclosure purchaser's only obligation would be to deposit the rent check.

From a lender's perspective, the lender-drafted SNDA form shifts to the tenant what the lender may regard as undesirable or unacceptable underwriting risks under the loan. Depending on how the lender perceives the magnitude of its own leverage in a loan transaction, the tenant may be asked in the SNDA to waive its right under the lease, among other things[8]:

- To be credited for prepaid rent, including its prepaid estimated charges for its pro rata share of common area maintenance, repairs and real property taxes;
- To demand completion of tenant and/or common area improvements by the foreclosure purchaser, or payment of tenant improvement allowance for improvements made to the premises;
- To recover its security deposit from the foreclosure purchaser upon expiration of the lease term;
- To enforce landlord warranties in the lease respecting use, zoning and title;
- To free rent
- To any unpaid arbitration award;
- To a purchase option;
- To a reduction in rent in specified circumstances, or to terminate the lease prior to expiration of the term upon the occurrence of certain events;
- To enforce the remedies it would otherwise have under its lease for the acts or omissions of the delinquent landlord;
- To offset rent or raise defenses under its lease, even to the extent that such rights against the landlord may arise subsequent to a foreclosure;
- To agree with the landlord to amendments to the lease without the lender's prior written consent;
- To look to the personal liability of the foreclosure purchaser for claims under the lease arising even subsequent to a foreclosure; and
- To enforce landlord warranties with respect to contamination from hazardous materials.

When lenders rely mainly upon the leases of credit tenants for the rent to service their borrowers' loans, attornment protection for the credit tenants, *not merely a promise not to disturb*, should not necessarily be ruled out. Typically, however, the landlord-drafted lease form contains a provision obligating the tenant to agree to subordinate its lease to the landlord's future lenders by signing SNDAs in whatever form may customarily be requested by the landlord's lenders. In recent years, however, many big-box retailers have insisted upon including their own form of SNDA as an exhibit to their leases, thus nailing down and limiting the extent of their obligation, if asked by the landlord to sign an SNDA. Here, landlords usually accommodate credit tenants.

Lenders, too, typically acquiesce—or at least put up less resistance—to the use of such pre-agreed SNDA forms when the issue is addressed at the outset of an underwriting, rather than as a check-off item late in the loan-closing process. Other credit tenants choose to use their sophistication and leverage to negotiate changes in lender-drafted SNDA forms.[9]

The extent of a lender's risk is not the same in all transactions and, therefore, changes to the lender's SNDA form with which the lender should be able to live may vary also. When commercial real estate loans are underwritten based primarily upon the creditworthiness of long-term credit tenants—rather than upon the value of the borrower's bricks and mortar *under the hammer*—obviously, lenders have as great an interest in ensuring that the leases are not wiped out by a foreclosure (and rental payments not interrupted) as do the tenants. This makes for a more even playing field.

The Lender Mind-set

The lender, when negotiating SNDA terms with a credit tenant, wants the right to cure landlord defaults that could otherwise result in an interruption in rental. The lender also wants to make sure that, after a foreclosure, the tenant will attorn to the foreclosure purchaser. Credit tenants should not have a problem accommodating the lender on those two issues. However, in the opinion of a growing segment of the real estate bar, the SNDA should not entitle a foreclosure purchaser to get rid of a credit tenant or to use that power as a threat in order to increase the rent. Nor should the foreclosure purchaser be exempt, necessarily, from any of the landlord's obligations under the lease after a foreclosure. Those risks can and should be taken into account by lenders as part of their loan underwriting process.

In practice, however, it may make a difference who the lender is and whether the landlord is negotiating a short-term construction loan or a long-term permanent loan. Other variables include whether the tenant is stand-alone or in-line; the kind of insurance available to the parties on that particular real estate; and whether the loan goes into the lenders' portfolio or is being packaged for sale to an originator of commercial mortgage-backed securities.

The lenders' position with respect to the SNDA is sometimes rationalized on the basis that the landlord's cost of money would be higher and, therefore, the tenant would have to pay more rent but for the lender-demanded shift in the underwriting risk. "*Blame the credit rating agencies*" is another popular refrain. If the truth were told, though, rents do not usually track interest rates. Rental rates are more likely to depend upon the magnitude of the demand for the available inventory of vacant space in the particular real estate market.

The lender mind-set, historically, has been to dispose of non-performing (i.e., delinquent) loans at a deep discount, rather than to advance the money and furnish the operational expertise needed to turn a shopping center around—even when it is blessed with a credit tenant, and even when this faintness of heart can result in compounding the lender's losses.

In this age of credit lease securitization and the resulting influence on the real estate market of Wall Street credit rating agencies, the tension between lenders and credit tenants over SNDAs is not likely to abate soon. To reverse the pre-disposition of lenders to disgorge non-performing loans, even in instances where credit tenants are operating successfully, may require a sea of change in lender philosophy. But, as credit tenants become more resistant to one-sided SNDAs that expunge their hard-won concessions and lease provisions, lenders may be compelled to re-examine their underwriting practices.

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[1] See *Dover Mobile Estates* v. *Fiber Form Products*, Inc., 220 Cal. App. 3d 1494, 1498 (1990) (hereinafter "*Dover*"); *Bank of America* v. *Hirsch Merc. Co.*, 64 Cal. App. 2d 175, 184 (1944); Miller & Starr, 3 CAL REAL EST. 2d ed. §8:82, p. 422 (1989).

[2] See *Dover*, 220 Cal. App. 3d at 1498; *Bank of America*, 64 Cal. App. 2d at 184; *Tanner* v. *Title Insurance & Trust Co.*, 20 Cal. 2d 814 (1942); Cal. Civ. Code § 2934 (West 1993); Nelson & Whitman, REAL EST. FIN. LAW 2d ed. 15.11, p. 1114 (1985).

[3] See, e.g., *Principal Mutual Life Ins. Co.* v. *Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th 1469, 1478 (1998) (hereinafter "*Principal*"); Dover, 220 Cal. App. 3d at 1498.

[4] See *Principal*, 65 Cal. App. 4th at 1478; *Dover*, 220 Cal. App. 3d at 1498; *People* v. *Little*, 143 Cal. App. 3d Supp. 14, 19 (1983).

[5] See, e.g., *Principal*, 65 Cal. App. 4th 1469; see generally Pamela L. Westhoff, *Lenders, Liens and Leases—Successfully Navigating the Maze of SNDAs, Estoppels and the Priority Jumble*, 441 CAL. REAL EST. LAW & PRAC., 429-44 (May-June 1999) (hereinafter "Westhoff")

[6] See, e.g., *Principal*, 65 Cal. App. 4th at 1479; *Dover*, 220 Cal. App. 3d at 1500; see generally *Johnson & Moskovitz*, CAL. REAL EST. LAW & PRAC. §153.50, 153-94.

[7] See generally Jane S. Kerpon, *Negotiating Provisions of a Subordination, Non-disturbance and Attornment Agreement*, 12 No. 11 COM. LEASING L. & STRATEGY 4 (April 2000) (hereinafter "Kerpon"); Westhoff, *supra* note 5.

[8] See Kerpon, *supra* note 7; *Westhoff*, *supra* note 5; Arnold B. West and Sidney A. Keyles, *Does the A in Your SNDA Work?*, 7 PROB. & PROP. 54, 56 (Sept./Oct. 1993) (hereinafter "West").

[9] See generally Peter A. Sarasek, *The Lender's Fingerprints in the Leasing Transaction*, 433 REAL EST. LAW & PRAC. 535-43 (1998); West, *supra* note 8.

Tenant Issues When Leasing Space in a To-Be-Constructed Space

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In the typical shopping center leasing scenario, the landlord and tenant agree upon the specifics of the tenant's buildout of the leased space, the tenant improvements are constructed and the lease commencement date is tied to the completion of those improvements. The situation becomes far more complicated, however, when the shopping center is under construction or when construction of the center has not yet started. The issues created by such a scenario are numerous, difficult to negotiate and, if not fully addressed, may place the tenant in a high-risk position.

In addition to the usual tenant improvement issues, the tenant needs assurances that (i) the shopping center, as constructed, will be what the landlord promised; (ii) the center will be completed on time and that there are appropriate remedies available if it is not; and (iii) the center will be adequately completed when the tenant moves in and is obligated to begin paying rent. No landlord, however, will be eager to give up flexibility in scheduling construction or changing the center's specifications, nor will the landlord relish tenant remedies such as liquidated damages or termination rights.

This article discusses why these issues are crucial for the tenant, and provides suggestions for reaching an acceptable balance between landlord flexibility in the construction process and adequate protection of the tenant.

Ensuring Tenant Gets the Building It Bargained For

Any tenant seeking space will first ask: "What type of space fits the requirements of my business and my budget?" If the center is already constructed, the potential tenant can simply view and inspect the center to see if the space is appropriate for that tenant's needs. If the center is not yet built, the tenant will have final, or perhaps only preliminary, building plans and specifications to review.

Final Plans and Specifications of the Building Already Exist

If, prior to execution of the lease, the landlord has final plans and specifications of the space, or perhaps construction has already begun, it is much easier for the tenant to feel assured that the space it will move into will be the space the landlord promised. Simply describe and reference the final plans and specifications in the lease as you would reference the tenant buildout final specs in the tenant improvements provision. In such a situation, the only problem is the landlord's desire or need to make changes to the final plans.

As a starting point, it is important to remember that changes will almost certainly be required as unforeseen problems surface during construction. The landlord needs a certain amount of flexibility in making changes, especially minor changes, without having to seek the tenant's consent. Additionally, the landlord may be concerned about changes that could be required under the terms of its construction loan or as a result of environmental or governmental directives. These concerns are legitimate ones, which need to be reconciled with the tenant's need to be sure the space will be built substantially as promised.

A good balance can be struck by incorporating the following dual-pronged approach. First, the landlord should be prohibited from making changes to the final plans and specifications that "materially, adversely affect tenant's rights under the lease" or that would reduce the overall quality of the space without the consent of tenant. Second, to further clarify what types of changes may not be made without the tenant's consent, the language should provide that there shall be "material alteration" to a specific list of items without the consent of the tenant. These specific items might include (i) the exterior design of the space; (ii) the specifications of certain systems such as HVAC; (iii) the location, size and number of parking spaces that service the shopping center; and (iv) means of ingress and egress thereto. There may be other items of particular concern depending on the situation.

Final Plans and Specifications of the Shopping Center Not Yet Complete

If the tenant is negotiating for space in a shopping center for which there are no plans, or only preliminary plans, the situation is a bit more complex. This usually occurs when there is one large, important tenant that is the impetus for the center (although do not confuse this situation with a true build-to-suit). As such, that tenant often has a fairly strong bargaining position in negotiating with the landlord and often wants to have a voice in the development of the building's plans and specifications. The tenant may, depending upon its needs and bargaining position, desire any number of the following: (i) the ability to review and comment upon intermediate stages of the development of the plans, (ii) approval rights related to a specific list of items (similar to the material alterations list above), or (iii) approval rights related to the entirety of the final plans. Many tenants are only able to negotiate for the landlord's "good faith consideration" of the tenant's comments or requests, while more powerful tenants may be able to negotiate a lease termination right if the parties are unable to agree on the final plans after a period (often 20–30 days) of good-faith negotiations.

The Construction Schedule

When the lease at hand involves any type of construction, the tenant will want to require the landlord to commit to completion of the construction and delivery of the premises on or before a specified date, usually subject to certain contingencies. In the case of tenant space buildout, the parties generally set deadlines for completion of the final plans, substantial completion of the tenant's work and delivery of the premises, and completion of any remaining punch-list items. Some tenants are able to negotiate rent abatement provisions, and more powerful tenants can gain termination rights in the case of landlord-caused delays. When the shopping center itself is not complete or is yet to be constructed, the tenant must also be concerned with the construction progress of the building.

Keeping the Landlord's Construction on Schedule

The level of protection a tenant will be able to obtain in regard to the center's construction schedule is generally a function of that tenant's bargaining power. This is an important issue for any tenant, however, because delays in construction of the center have the potential to be lengthy and translate into (i) lost opportunities for good space in other locations, (ii) increased expenses for the tenant in the form of holdover rent if the tenant is forced to holdover in its existing space after the termination of its lease, (iii) increased expenses if the tenant must obtain temporary space elsewhere, or (iv) lost revenue if the tenant's business is interrupted because the space is not ready on time.

The best method for keeping the landlord on its construction schedule is by the development of a system of "milestone dates." For example: (i) construction loan closed and evidence that all necessary government approvals have been obtained (this will usually be applicable only where construction on the building has not yet begun), (ii) all foundations and footings substantially completed, (iii) different substantial completion dates applicable to specific phases of the center and (iv) delivery of the tenant's space in agreed-upon condition. The landlord will resist this notion, but a savvy tenant will "dig in its heels" and remind the landlord that as the construction process moves forward the tenant invests increasing amounts of money, has passed on other opportunities and finds itself with increasingly less time to locate new space if the landlord falls drastically behind schedule. Additionally, landlords will almost always demand some type of *force majeure* extension of milestone dates. It is reasonable to provide for *force majeure* extension of some of the early milestone dates, but tenants should argue that it is the landlord who is in the real estate development business and, therefore, must ultimately bear the risk of force majeure delays.

Potential Remedies for Missed Milestones

The most important remedies available to tenants for the landlord's failure to meet milestone dates are termination rights accompanied by liquidated damages payments and rent abatement; per diem penalties; and reimbursements for holdover rent, temporary space costs and other expenses caused by landlord's delay. A termination right is necessary to protect the tenant from "doomsday" events such as destruction of the partially constructed center, financing problems or other events that put the building construction substantially behind schedule. Realistically, these "worst case" scenarios are not likely, yet the tenant could face substantial losses if any were to occur and, most importantly, the tenant needs the right to terminate so it can pursue another solution to its space needs.

Often, only powerful tenants are able to negotiate for termination rights and the receipt of liquidated damages if the landlord misses a milestone date. Tenants should negotiate for an amount of liquidated damages that increases with the passing of each milestone. For example, if the landlord fails to meet milestone #1 and the tenant elects to terminate the lease, the landlord might be obligated to pay $100,000 in liquidated damages; if milestone #2 is not met and the tenant elects to terminate the lease, the landlord might be obligated to pay $250,000 in liquidated damages, and so on. The argument behind this type of increasing payment schedule is that, with each passing milestone date, the tenant is spending money having buildout plans created, finishes selected, scheduling movers, and the like, and at the same time is passing on other opportunities for space. The later in the game the landlor "drops the ball," the more it costs the tenant.

As opposed to the fairly unlikely doomsday events, the possibility that the landlord will simply fall behind schedule and achieve completion later than projection is very real. Accordingly, the tenant needs to negotiate for the recovery of costs caused by late delivery of the space (and assuming the tenant does not terminate the lease). Such costs could include (i) holdover rent on any existing lease, (ii) the cost of temporary space and (iii) costs associated with rescheduling the move to a later date. This is a reasonable request so long as the tenant is obligated to mitigate those expenses. Rent abatement or a predetermined per diem penalty are two easy ways to quantify a payment in the event of a landlord delay and are often used in conjunction with the other remedies discussed above.

Determining "Substantial Completion"

Another important issue in renting space in a center that is under construction or prior to the commencement of its construction is the determination of when the building is adequately completed and, in turn, when the tenant must begin paying rent. It is very important to outline specifically in the lease what constitutes substantial completion. In regard to the tenant's leased space, this will generally mean delivery of the tenant's space in some agreed-upon condition, which will vary depending on who is doing the tenant's construction work. If the tenant will be doing its own buildout, the landlord will typically deliver the space in "base building condition." The lease should contain a detailed description of the base building condition (which will be constructed at the landlord's expense and will not be deducted from the tenant improvement allowance) that will likely include completion of (i) core walls with readiness for finishes, (ii) concrete floor slabs, (ii) the ceiling, and (iii) electrical and HVAC service installation. If the landlord is conducting the buildout, the landlord will be obligated to deliver the tenant's space in accordance with the tenant's final plans and specifications, excepting punch-list items.

A somewhat more complicated matter is that of defining substantial completion, as it relates to the center. Landlords often try to tie the definition of substantial completion to the issuance of a certificate of occupancy (CO). Tenants sometimes mistakenly accept that definition and do not realize that many jurisdictions regularly issue COs when a building is still in a state of disarray. Landlords also try to tie the definition of substantial completion to the issuance of an "architect's certificate of substantial completion" on an AIA approved form. Again, many tenants will accept this definition—not realizing that, similar to tying the definition to the issuance of COs, there could be incomplete work ranging from punch-list items to major items.

Tenants should negotiate for a definition of substantial completion of the center that is as specific as possible. A comprehensive approach includes all or a combination of the following: (i) issuance of a certificate of occupancy; (ii) issuance of a certificate of substantial completion from the architect; (iii) all primary building operating systems as described in the final plans are operational; (iv) functional rest rooms within tenant's space with finishes installed; (v) tenant has safe and unimpeded access to the shopping center, its premises and any parking facilities; and (vi) the common area is substantially complete (less punch-list items). It is important that all the construction in the immediate vicinity of the leased premises is substantially complete and that neighboring stores have been substantially constructed and, if possible, are also open for business.

Conclusion

When representing a tenant that is leasing space in a shopping center that is not yet constructed, there are many important issues that must addressed to adequately protect a client's interests. The situation is far more complicated than leasing space in an existing center and, even though the risk of a doomsday event is low, the costs to the tenant if one should occur could be dramatic. A tenant must be assured that the finished space and center will be substantially similar to the space and center that the landlord promised, that there are adequate mechanisms in place to motivate the landlord to keep its construction on schedule, that there are remedies available to the tenant if the landlord fails to do so, and that the definitions of completion of the premises and the building are acceptable.

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The Importance of the Co-tenancy Clause

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The importance of a well-drafted co-tenancy clause was recently illustrated in *Winn-Dixie Charlotte, Inc.* v. *Brunner Companies Income Properties Limited Partnership I*, 2000 Ga. App. Lexis 987. The *Winn-Dixie* court relied on other cases to determine that, absent a co-tenancy clause, a shopping center tenant could not terminate its lease when the center's anchor tenant went dark.

This article will discuss the *Winn-Dixie* decision and the cases on which it was based, and provide sample co-tenancy and continuous operating clauses.

The undisputed facts were that Winn-Dixie entered into its lease relying on the landlord's representations that Wal-Mart was to be the anchor tenant of the shopping center with a 20-year non-cancellable lease. Based on the landlord's assurances about Wal-Mart's occupancy in the shopping center, Winn-Dixie entered into a lease with the landlord. Wal-Mart, in fact, did open a retail store in the shopping center; however, 12 years into the lease term, Wal-Mart ceased using the premises as a retail operation and began operating the space as a service/warehouse.

The parties admitted that Wal-Mart was "a significant anchor tenant that drew customers to the shopping center." Wal-Mart at all times remained in good standing under its lease. Winn-Dixie filed suit to terminate its lease for breach based on Wal-Mart's failure to continuously operate as a retail store. The lower court held that Winn-Dixie, based on the clear and unambigious language of its lease, did not have sufficient grounds to terminate its lease. The court of appeals affirmed and stated that the co-tenancy clause contained in Winn-Dixie's lease did not require continuous operation by Wal-Mart as a retail store.

It is important to note that Winn-Dixie was the drafter of the lease; furthermore, the lease did not contain express language that Wal-Mart must continuously operate as a retail establishment. The court stated that it "cannot impose a continuous operation condition by implication." In reaching this conclusion, the court looked at several other cases where continuous operation was implied between the landlord and tenant.

See *United Dominion Realty Trust, Inc.* v. *Wal-Mart Stores, Inc.*, 307 S.C. 102, 105-106 (413 S.E.2d 866)(SC App. 1992) and *Columbia East Assoc.* v. *Bi-Lo, Inc.*, 299 S.C. 515, 521-522 (386 S.E.2d 259)(SC App. 1989). In *Columbia East*, the anchor tenant was a grocery store ("Bi-Lo") whose lease did not contain a continuous operation clause. However, two of the smaller tenants' leases did contain provisions that either allowed the cancellation of the lease or made the lease contingent upon a lease being entered between the landlord and the grocery store. Bi-Lo relocated to an adjacent shopping center, ceased to operate the store in any capacity and refused to sublet the premises; however, it did remain current with the rental obligations under the lease.

The landlord here argued that Bi-Lo had an obligation to either operate as a grocery store or, in the alternative, to sublease the space to another store. The court found that the lease was silent both as to Bi-Lo's continuous operation and whether Bi-Lo was required to sublease the premises. The court then looked to the parties' intent when the lease was drafted. The court found that when the lease was negotiated, both parties intended that the premises would be operated as a grocery store. Furthermore, neither party entered the lease with the intent that the store would be empty. Furthermore, Bi-Lo testified that it did not enter the lease intending to pay rent on a vacant store.

The court held that the requirement of continuous operation is one of good faith and that, under the circumstances, Bi-Lo did not act in good faith. Not only did Bi-Lo fail to make a "sincere effort" to sublease, but when it was presented with an offer, it refused to sublet to another grocery store based on the grounds that the sublease would create competition for Bi-Lo, which had relocated just 200 feet away. The intent of the parties, combined with Bi-Lo's bad faith, supported the finding of an implied covenant of continuous operation; consequently, the court in *Columbia East* held that Bi-Lo had breached its lease.

In *United Dominion,* the court also found that there was a covenant of continuous operation. However, the court in *United Dominion* based its decision on the language of the lease rather than the parties' intent in drafting the lease, as in *Columbia East*. In *United Dominion*, the language of the lease required that Wal-Mart operate its business "with due diligence and efficiency in an effort to produce all of the gross sales which may be produced. . . ." The court determined that this phrase prevented Wal-Mart from ceasing sales operations and using the premises for storage. It should be noted that Wal-Mart's lease required percentage rent to be paid to the landlord, and that Wal-Mart's failure to operate as a retail sales store deprived the landlord of additional rents for which it had bargained.

Other factors courts have looked at in determining whether there is an implied covenant of continuous operation include (i) whether the lease requires percentage rent and, if so, whether there is a substantial minimum rent; (ii) whether the tenant is permitted to sublease the premises and, in conjunction with this, whether the landlord's consent is required; and (iii) the permitted use of the premises—i.e., for the sole purpose of a grocery store or for any legal use. See *Piggly-Wiggly Southern Inc.* v. *Heard*, 261 Ga. 503 (405 S.E.2d 478) (1991); *DPLM, LTD.* v. *J. H. Haverty Co.*, 241 Ga. App. 219 (526 S.E.2d 409)(1999); and *Kroger Co.* v. *Bonny Corp.*, 134 Ga. App. 834 (216 S.E.2d 341) (1975).

Based on the holdings in *United Dominion* and *Columbia East*, the court in *Winn-Dixie* found that a continuous operation condition "cannot be implied as to an anchor tenant by another tenant, absent express language to that effect."

Since the court in *Winn-Dixie* refused to imply a covenant of continuous operation, it looked to the plain language of the lease. The co-tenancy clause in Winn-Dixie's lease merely required Wal-Mart to "occupy" its premises in the shopping center. The court gave "occupy" its plain meaning and refused to interpret "occupy" to mean "continuously operate a retail store or service center." Occupying its premises as a storage warehouse fulfilled Wal-Mart's leasehold obligation to occupy the premises. Therefore, since the co-tenancy clause did not clearly state what Winn-Dixie Intended—i.e., that Wal-Mart was to continuously operate as a retail store—the court found that the co-tenancy clause was not violated and, consequently, Winn-Dixie was not permitted to terminate its lease.

From a landlord's perspective, a landlord should be leary of including co-tenancy clauses in smaller tenant's leases without including an express continuous operation clause in the anchor tenant's lease. Therefore, if a landlord is pressured to include a co-tenancy clause, the anchor tenant's lease should have a continuous operation clause so that the landlord has a remedy against a breach of the co-tenancy clause.

The *Winn-Dixie* case not only demonstrates the importance of having a well-drafted co-tenancy clause containing continuous operation language, but also a continuous operation clause in the anchor tenant's lease. If the landlord affords the smaller tenants an opportunity to terminate their leases when the anchor tenant ceases to operate in the manner contemplated by the parties, it is extremely important for the landlord to require the anchor tenant to operate continuously as a retail store that attracts customers.

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Landlord Remedies in Commercial Leasing—A Surprising Lack of Uniformity

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The Property Law Paradigm

Under the property law paradigm the landlord has only the responsibility to transfer good title to the right of possession. Courts read few if any "implied conditions" into the lease. The landlord has no obligation to give "actual possession" to the tenant or to deliver the premises in any particular condition. Further, the express covenants are treated as "independent" of each other, so that a breach by the landlord does not excuse performance by the tenant. Instead, the tenant must sue for damages.

Furthermore, the landlord has no obligation to minimize the loss incurred because of tenant's breach—i.e., no duty to mitigate damages. The landlord has "sold" the tenant an interest in land; the tenant must pay the "purchase" price or full rent. Indeed, if the lease provides, the landlord may even accelerate the rent due upon the tenant's breach. Under this view, there is no requirement to act in "good faith" or "reasonably." The landlord's right to collect the full rent for the term of the lease is reduced only if the landlord takes back possession from the defaulting tenant.

The Contracts Law Paradigm—A New Duty to Mitigate and Reluctance to Validate Acceleration Provisions

Over the past 30 years the courts have begun to view a lease as more like a contract than a conveyance of an interest in land. First, cases involving residential leases found a "warranty of habitability" similar to the UCC warranty of fitness for a particular purpose. Second, courts began to treat both implied and express covenants as "interdependent" so that breach by the landlord of a material term of the lease excuses performance by the tenant. If the premises are rendered useless to the tenant or if the tenant is ousted, even by an outsider, the tenant's obligations are excused. Third, even where the tenant defaults, the landlord has a new duty to "mitigate" damages. Finally, as with contract terms, generally, if an acceleration clause in a lease amounts to a "penalty" in the court's mind, the court will invalidate it.

Increasingly, these "contracts principles" have been applied to commercial leases as well. However, the changes pertaining to the landlord's remedies in commercial leases vary considerably from state to state. A review of recent case law and legislation in several key jurisdictions indicates the extent of this so-called "paradigm shift."

Landlord's Duty to Mitigate Damages

New York courts continue to show the greatest respect for the property law paradigm. The state's highest court reaffirmed its adherence to the non-mitigation rule in *Holy Properties Limited, L.P.* v. *Kenneth Cole Prods. 87 N.Y. 2d 130,* 661 N.E. 2d 694 (N.Y. 1995). The tenant stopped paying rent and vacated three years before the end of a 10-year lease of office space. There had been a change of ownership and a general deterioration of the building during the tenant's occupation. The landlord brought a summary eviction proceeding, seeking rent arrearages and damages. The tenant offered an affirmative defense of failure of the landlord to mitigate damages. Both the trial court and the appellate division found in favor of the landlord. New York's highest court, the Court of Appeals, insisted on the importance of "settled rules" to those in business transactions and cited the long-standing landlord-tenant rules based on the property paradigm in reversing the lower courts.

New York's highest court did not concern itself with the general principle that the landlord would only be entitled to rent before the tenant vacated but instead found no duty to mitigate, even where the landlord sued to evict. In fact, the court did not base its decision on an even easier ground—here, the lease itself expressly provided that "landlord was under no duty to mitigate…. And that upon either tenant's abandonment or eviction," the tenant would remain liable for the entire rent. Subsequent New York courts have followed the *Holy Properties* rule, even in residential landlord-tenant settings.

In 1998, in a widely anticipated decision, the Pennsylvania Supreme Court concluded that "in modern landlord tenant law, leases have a dual nature both as conveyances and also as contracts" *Stonehedge Square Limited Partnership* v. *Movie Merchants, Inc.,* 552 Pa. 412, 715 A. 2d. 1082, 1082–1083 (Pa. 1998). Then it proceeded to give no guidance at all as to "when" those contracts rules should apply or indeed "if" they will ever apply.

In *Stonehedge,* the tenant, an assignee of a five-year shopping center lease, abandoned the premises and stopped paying rent with nine months to run on the lease. While it was unclear what damages the landlord actually sought, the court held that the non-breaching landlord has no duty to mitigate damages. The court cited five reasons for holding onto the property paradigm:

- Leases have been bargained for in reliance on the Common Law rule.
- There is a fundamental unfairness in allowing a breaching tenant to require the non-breaching landlord to mitigate damages caused by the tenant.
- Pennsylvania legislative reform of landlord-tenant law did not change the Common Law on this issue.
- By the terms of the lease the tenant had the ability to reduce its own damages by assignment or sublease. And,
- The established rule is simple—no need to deal with new issues that arise with mitigation.

In contrast, in *Austin Hill Country Realty, Inc.* v. *Palisades Plaza, Inc.,* 40 Tex.Sup.J 924 948 S.W. 2d 293 (Tex. 1997), the Texas Supreme Court joined the majority of states in adopting contract rules requiring mitigation in certain situations. Real estate brokers had executed a five-year office lease, but could not agree about the leasehold improvements. When the date for possession passed without resolution of those items, the landlord sued for anticipatory breach. The tenants asked for a jury instruction: reduce the damage awarded by the amount that could have been avoided by the landlord's reasonable care. In denying the tenants' request, the trial court judge commented, "Last time I checked the law, it was that a landlord doesn't have any obligation to try to fill the space."

In *Austin Hill* the Texas Supreme Court provided yet another "history" of the legal treatment of leases and concluded that it was appropriate to announce a change in the law to respond to changes in the relationship: (1) lease covenants are more complex and more important to the tenant—" the lease is not a complete conveyance to the tenant for a specified term such that the landlord's duties are fulfilled upon deliverance of the property"; (2) the landlord-tenant relationship (especially in the commercial context) is no longer a "personal one" that justifies the no-mitigation rule; (3) all kinds of public policies support a mitigation requirement: avoid waste, productive use of property, disfavoring penalties.

The Texas Court also emphasized that a duty to mitigate arises when the landlord seeks a contract remedy like "anticipatory breach." Thus, if a landlord actually reenters or the tenant allows the landlord to reenter without accepting surrender, forfeiture of the lease or being construed as evicting the tenant, there is a mitigation duty. Whereas, if the landlord maintains the lease and sues for rent as it comes due, there is no such duty!

The opinion does offer some practical guidance on dealing with this new requirement:

- Only "objectively reasonable efforts" are required.
- Landlord's failure to mitigate bars landlord recovery "only to the extent that damages could have reasonably been avoided."
- The tenant bears the burden of proof to demonstrate that the landlord has mitigated or failed to mitigate damages and the amount by which the landlord reduced or could have reduced damages.

Statutory Schemes: Illinois & California

Legislatures in Illinois and California have attempted to provide certainty on the issue of the landlord's duty to mitigate. In Illinois, a landlord shall take "reasonable measures" to mitigate damages. 735 Ill Comp. STAT. A.NN. 5/9—13.1 (West 1992). This rule applies to both commercial and residential landlords. An Illinois appellate court had a chance to apply this requirement in a case arising out of a 1988 office lease—a lawyer's office lease, no less! The 10-year lease, executed in a period of high downtown vacancy rates, provided for a rent abatement for the first 33 months. The tenant was to pay only its pro rata share of taxes and operating expenses during that period. Three and one-half years later, the law firm dissolved and the partners vacated. The landlord terminated the lease four months later, reserving its right to sue for damages under the lease. The tenant raised mitigation as an affirmative defense.

The court, in *St. George Chicago, Inc.* v. *George J. Murges & Associates*, 296 Ill. App. 3d 285, 695 N.E. 2d 503 (1998) petition for leave to appeal denied, 179 Ill. 2d 618.705 N.E. 2d 449 (1998), held that a provision in the lease which entitled the landlord to recover the present value of the rent over the unexpired lease term, less the present value of the fair market value over the period, meets the statutory duty to mitigate. Thus, for the period after termination, the landlord's actual efforts are not relevant; but, during the pre-termination period the burden is on the landlord to show "actual reasonable measures to mitigate." Importantly, the court construed the statute as not barring any recovery, but only as reducing damages.

Especially by its 1989 amendments, the California legislature provides a comprehensive scheme of landlord remedies after tenant default. CAL. CIV. CODES, Sec. 1951.2 -1951.4 (West 1998). Most importantly, Section 1951.4 provides a "safe harbor" of specific language so that the landlord can avoid the duty to mitigate damages.

The statute permits the landlord to treat the lease as continuing (even though the tenant has breached and abandoned) so long as the landlord does not terminate the right to possession if:

- The lease permits or does not prohibit or restrict right of the tenant to sublease and/or assign; or
- The lease permits the tenant to sublet and/or assign subject to express standards that are reasonable at the time the lease is executed and the landlord does not require compliance with any standard that has become unreasonable at the time of assignment/sublet (there is a presumption that the express standard is reasonable); or
- The lease permits the tenant to sublet and/or assign with the consent of the landlord and that consent shall not be unreasonably withheld.

Moreover, the statute clarifies that none of the following conduct constitutes "termination" of the tenant's right to possession: acts of maintenance or preservation or attempts to re-let; appointment of a receiver upon landlord's initiative; and withholding of consent if withholding is not unreasonable.

The rationale for this allocation of the burden of minimizing the loss and relieving the landlord of a duty to mitigate would prove most useful where the landlord "does not have the desire, facilities or ability to manage the property and acquire a suitable tenant."

Conclusion—Unresolved Legal Issues Concerning the Duty to Mitigate

Questions remain, even in the majority of states that do require mitigation by the landlord:

Does the landlord's failure to mitigate preclude recovery or merely reduce the amount of damages? And what will be the measure of damages? A New Jersey Court, *in Harrison Riversides Limited Partnership* v. *Eagle Affiliates, Inc.* 707 A. 2d 490 (N.J. Super. 1998), referred to the Uniform Commercial Code measure of damages in sale of goods and applied it to damages for breach of real estate sales contract in a declining market: the difference between the agreed-upon price and the *subsequent sales price* instead of the market value *at the time of the breach*.

- Which party has the burden of proof, and what is the test of conduct?

- What are the guidelines to determine whether the landlord has mitigated? The so-called "reasonable efforts" standard does not clarify, for example, whether the landlord may make improvements for the new tenant and whether such costs will be borne by the landlord or by the breaching tenant.
- What is the effect of an express provision to the contrary in a lease? Generally, express provisions will relieve the landlord of duty, but some case law and statutes (California) require that the tenant have a right to assign or sublet.

Acceleration Clauses

The Common Law property analysis is that the lessor is entitled to full payment for the "conveyance" of the leasehold interest. Indeed, in commercial leases the rent often is stated for the entire term and installment payments, often monthly, are provided for as a method of collecting the "purchase price." Thus, if the tenant defaults and the lease has an acceleration clause, the landlord should have an action for future rent at least where the tenant remains in possession and the landlord makes no attempt to retake possession. A New York appellate court following *Holy Properties* held that in a residential lease, even if the landlord evicted the tenant, the landlord could enforce an express acceleration clause and was under no duty to mitigate. *Duda* v. *Thompson,* 169 Misc.2d 649, 647 N.Y.S. 2d 401 (1996)

A Pennsylvania court, in *Homart Development Co.* v. *Sgrenci,* 443 Pa. Super. Court 538, 662 A.2d 1092 (1995), forced the landlord to elect between the remedies of possession and monies for the entire term, even where an express provision in the lease provided that all remedies are cumulative and where there was an express provision for acceleration. Indirectly, the court rejected the contract analysis that views accelerated damages of future rents as liquidated damages.

Liquidated Damages Analysis

Courts in several jurisdictions have looked at the express acceleration provisions of a lease in light of liquidated damages principles. In *Teachers' Retirement System of the State of Illinois* v. *American Title Guaranty Corporation*, 38 Va. Cir. 316 (Va. Cir. 1996), a Virginia court reviewed an acceleration clause in a commercial lease where there was no provision for discounting the future rent to its present value nor one to entitle the tenant to any offset if the landlord re-let the property. The court held that an agreement that provides for liquidated damages "grossly in excess of actual damages" or where actual damages can be definitely determined will be "deemed a penalty." Because the lease provided no benefit to the tenant if the landlord re-let the premises, there was a "potential windfall" to the landlord. The lease's failure to make provision for the impact of future market conditions or the probability of re-letting made the acceleration clause unenforceable.

In a 1993 Illinois case the appellate court reversed a directed verdict in favor of the tenant on the landlord's claim for accelerated rent. *Leahy Realty Corp.* v. *American Snack Foods Corp.,* 253 Ill. App.3d 233, 625 N.E.2d 956 (1993). The lease contained a liquidated damages clause whereby the tenant forfeited its security deposit. However, a subsequent clause provided that the liquidated damages were "in addition to and not in lieu of all other rights and remedies afforded the landlord." In noting that the acceleration clause reduced the landlord's damages by "the fair rental value of the leased premises…" and even though the tenant did not contend that the acceleration clause was a penalty, the court's ruling for the landlord probably reflects the Illinois inclination to apply the liquidated damages test to such clauses.

The Iowa Supreme Court enforced an express acceleration clause in *Aurora Business Park Associates, L.P.* v. *Michael Albert, Inc.,* 548 N.W. 2d 153 (Iowa 1996). Two years into the lease, the tenant vacated and stopped paying rent. The landlord retook possession and tried to re-let the premises. Unable to find an alternative tenant, the landlord sued to recover past unpaid rent and the balance for the remaining term. The tenant argued (1) that the acceleration clause was an unenforceable penalty or, in the alternative, (2) that the court should offset any future rent award by the reasonable value of the premises to the landlord or the reasonable amount for rent the landlord would actually receive. After reviewing the conflicting case law in other jurisdictions, the Iowa court adopted the Restatement of Property (Second) Landlord & Tenant position that treats an acceleration clause as a "valid expansion of a landlord's remedy." Under the Restatement, the clause will be enforced where the tenant abandons and fails to pay rent so long as the "provision does not constitute a penalty."

Because Comment i of the Restatement requires the landlord to mitigate in such situations, the Iowa Supreme Court held that the lease must give the landlord this option for the tenant to be liable for the difference between the stated amount and what the landlord actually receives from a new tenant. It approved the language in the lease in the case and, thereby, suggests the exact language that the landlord should try to negotiate for use in future leases.

Moreover, the Iowa Court rejected the tenant's contention that the measure of damages should be the remaining rent due minus the reasonable fair market value of the premises for the balance of the term. Citing the Restatement of Contracts (Second), Sec. 356 CMT.B (1981), the court said that it would enforce liquidated damages clauses only when the damages approximate the loss anticipated at the time of making the contract. Also, although usually the validity of such a clause is determined *as of the date of execution of the contract,* the court ruled that the two and a half years remaining *at the time of breach* was too long a period to ascertain actual damages. Furthermore, because the lease expressly took into consideration the landlord's duty to mitigate by offsetting any claim by rent received in re-letting, the court ruled that the acceleration clause "reasonably approximate[d] anticipated or actual damages." Still, the court did not require an adjustment of the accelerated amount to present value. It provided no guidance as to the process by which the tenant can get any new rents collected by the landlord after the judgment for accelerated rents is entered. Does the court retain jurisdiction? Or, will the tenant have to sue the landlord?

Final Remarks

There are no consistent patterns among the courts addressing a landlord's duty to mitigate, other than the sheer inconsistency from one jurisdiction to another. There is a localism that is driving national landlords and tenants wild.

Perhaps now is the time to consider seriously a Uniform Commercial Leasing Act that would at least have the virtue of providing more certainty and uniformity in some major aspects of the relationship between commercial landlords and tenants, especially with respect to remedies available to the non-breaching party.

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In Practice

Five Steps an Owner Should Take to Terminate a Construction Contract Properly

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Introduction

When a construction contract is not performed to an owner's expectations, it is imperative that the owner not react in frustration or anger by immediately terminating the contract. Such an emotional reaction may result in even greater problems, including legal action for breach of contract, the cost of obtaining a replacement contractor, the expense of extending the completion time, damage to the owner's reputation and the potential for double payment for work performed. Accordingly, terminating a contract without prior planning and preparation can be a dangerously expensive course of action.

Although a frustrated owner might think that deviations from the contract provide sufficient grounds for termination, an owner can properly terminate a contract, generally speaking, if the contractor fails or refuses to work (and the contractor can terminate if the owner fails to pay). In addition, many contracts specifically limit grounds for termination by including an exclusive list of reasons in contract provisions. Good grounds for termination, therefore, must consist of incidents that materially breach the contract or a breach that goes to the essence of the contract.

Even after an owner has exhausted all avenues to remedy disputes with the contractor and good grounds for a proper termination exist, an owner still should take certain steps prior to implementing termination in order to avoid or reduce legal controversy and expense. If a post-termination claim by a contractor for breach of contract should occur, these steps also should help to provide an owner with a defense since the owner, as terminating party, bears the burden to show that proper termination occurred.

Five of the steps an owner should take to terminate a construction contract in order to reduce the potential for legal controversy and expense are discussed below. This discussion assumes that the termination procedures in the American Institute of Architects (AIA) apply. However, the information below generally will apply to a majority of construction contracts.

Step One: Owner Must Perform All of Its Obligations Under the Contract

In order to claim good grounds to terminate, the owner must make sure it has completed its own contractual responsibilities and not created any serious impediments to completion of the contractor's work. For example, if the owner fails to perform on time its obligation to prepare the site before the contractor begins work, and such failure results in delaying the start of the project, the owner cannot later claim delayed work without taking into consideration the owner's own failure to timely perform. Although the owner might have other good grounds on which to terminate, any claim must take into consideration the owner's faults, even if those faults occurred at the beginning of the contract and termination occurs several months—or even years—down the line.

Another contractual obligation an owner must perform prior to termination is to pay the contractor in a timely fashion once the architect certifies the contractor's request for payment. Accordingly, in order to claim good grounds to terminate, an owner must make sure it timely pays the contractor throughout the project.

The owner also must continue to perform its obligations under the contract once termination has occurred, even though the contractor may record mechanic's liens against the property and/or initiate a breach of contract action. Generally, after the termination, the owner has the right to stop work, take possession of the site and materials, and then finish the project by any reasonable method. If the contractor continually failed to pay its subcontractor, the owner may be able to withhold payment to the contractor until the entire project is completed. However, even though the owner's post-termination rights have been invoked, the owner must not stop performing its contractual obligations to the contractor.

After the project is completed, the owner is liable to the contractor for the reasonable value of the work it performed at the site. Accordingly, in order to help the owner meet its post-termination responsibilities in what might be a heated environment, the owner and its architect should determine immediately upon termination the reasonable amount of payment, if any, due to the contractor for work performed and materials supplied at the site. The construction contract likely will provide that if the amount owed to the contractor exceeds the costs to complete the project, then the excess should be paid to the contractor when the project is complete. On the other hand, if completion costs exceed the amount owed to the contractor, then the contractor should pay the difference to the owner.

In determining the amount the owner is going to withhold from or pay to the contractor, it is important to note that the more money withheld from the contractor, the easier it will be for the contractor to convince the court that the owner had ulterior motives for termination. Accordingly, the owner should not create a false or padded overage such that the owner's credibility is destroyed or the court questions valid grounds for termination. Thus, if the owner is going to withhold funds, be sure that there are solid grounds to do so. Step Two below should assist the owner in establishing such grounds.

Step Two: Put Observations in Writing

While it is important to document each phase of construction to make sure that work is performed in accordance with the contract documents, it also is important to have such documentation in case of an eventual termination. From ground breaking to ribbon cutting, it is essential to observe and document the status of construction—both good and bad—and maintain such observations and documentation in writing. In the event an owner is faced with terminating a contract, all of the owner's comments detailing events leading up to and including termination will be available to support the owner's decision to terminate.

An example of such documentation would be to record in the project log each time a contractor falls behind on the construction schedule. Although minor deviations from the schedule likely would not be considered good grounds to terminate, an owner might have such grounds if the aggregate delays are significant enough to affect the substantial completion date or interim milestone dates (dates set for completion of certain phases of the project) where these dates are set forth in the contract. However, if a contract does not provide that "time is of the essence," and since construction delays are common on most projects, it is possible that even a major delay might not be considered a material breach upon which an owner can properly terminate.

In summary, an owner's notes and reports can tell the owner's side of the story so that, in the event termination occurs, these documents can be used to support the owner's decision to terminate.

Step Three: Give the Contractor an Opportunity to Cure

After an owner has performed its obligations under the contract, carefully documented each phase of construction and decided to terminate the contractor for a material breach of the contract, an owner must allow the contractor time to cure its faulty performance, which is known as an opportunity to cure. This opportunity to cure is the contractor's last chance to fix what is wrong and avoid termination.

In order to perfect an opportunity to cure, most contracts require an owner to send the contractor written notice that there are deficiencies in the construction work. The written notice should list all of the claimed construction defects and/or delays and provide the contractor a reasonable amount of time to commence performance of a cure before the owner may terminate. If the owner fails to allow the contractor an opportunity to cure, then any of the contractor's defective or delayed work will not constitute a breach or justify termination. Moreover, failure to provide an opportunity to cure prior to termination may be considered a breach of contract on the owner's part, even if the construction clearly was defective or delayed by the contractor. But if an owner gives the contractor written notice to cure plus a reasonable amount of time in which to execute such a cure, and the contractor fails to do so, then an owner can continue the process of properly terminating the contract.

Step Four: Receive Certification from the Owner's Architect or Engineer That Sufficient Cause Exists to Justify Termination

Once it seems clear that the contractor is not making reasonable efforts to remedy the defects listed in the cure notice, the owner's next step is to discuss termination of the contract with its architect and/or engineer. Under most construction contracts, including the AIA A201, an owner must receive certification from the project's engineer or architect that termination of the construction contract and the reasons stated for such action are justified. The purpose of this provision is to provide the contractor with protection from an arbitrary decision by an owner to terminate for unreasonable grounds and insufficient causes. Although the architect or engineer likely has contracted with the owner and not with the contractor, the architect or engineer is to provide a neutral opinion as to whether termination is warranted.

An architect or engineer's certification is not always mandated by the contract. However, even if a contract does not provide for such certification, it is highly recommended to obtain such an opinion because a neutral opinion that termination was justified under the contract will become an important document if the contractor accuses the owner of wrongful termination. In the event of litigation, an owner can support its decision to terminate with its own opinion and documentation plus the written opinion of a neutral party at the construction site.

Step Five: Provide Contractual Notice of Termination

If the contractor neither fixes the defects nor assures the owner that the contractor can timely complete the project, and the owner has received proper certification that termination is justified under the contract, then the owner may proceed with termination. In order to proceed properly, written notice of termination must be provided to the contractor. However, before providing the contractor with written notice of termination, the owner first must review the contract's termination provisions to determine any other procedures that must be followed to effect such a termination.

When the owner does provide the contractor with a notice of termination, the notice should list the precise reasons for the contract's termination and state the time when termination will occur. Although the termination notice may be similar in substance to the cure notice, the contractor is not given any time to remedy its faults. Rather, the purpose of the notice of termination is to allow both the owner and contractor to make adjustments at the site in preparation for termination, such as determining whether the subcontractors will be paid or will continue to work under the replacement contractor.

Examples of precise contractual reasons for an owner's termination of a contractor may include those provided for under Section 14.2 of the AIA contract: (1) for persistent or repeated refusal to supply materials or labor; (2) for failure to pay subcontractors; (3) for persistent disregard of laws, ordinances, or rules, regulations or orders of a public authority; and (4) for an otherwise substantial breach of a provision of the Contract Documents. Although the fourth example may seem somewhat broad, the words "substantial breach" mean that the reason for termination must go to the essence of the contract, thereby defying the contract's purpose.

It is important to re-emphasize that the owner cannot simply end its relationship with a contractor in haste, even at this point. It is imperative that the owner determine the contractual procedures that must be followed throughout this process and then follow them. Each action taken by the owner must be performed in accordance with the contract because it is the terminating party's burden (in this case, the owner) to show that termination was justified, not the terminated party's burden (in this case, the contractor) to show that termination was wrongful.

After performing all of these steps and procedures, plus any additional steps and procedures provided for by each individual construction contract, the owner may terminate the contract. Termination formally ends the owner's contractual relationship with the contractor. The owner then may take possession of the project site, including all materials and equipment thereon, and complete the contract with a new contractor.

Post-Termination Effects to Consider

Once the contract has been terminated, the owner should have the right to withhold payment and finish the project by whatever method the owner deems expedient. In doing so, however, the owner should consider post-termination effects regarding its choice of replacement contractor as well as post-termination litigation that could occur. If the owner fails to consider post-termination consequences, this failure can be quite costly. In fact, some of these consequences may be more time-consuming and expensive than allowing the original contractor to continue in a miserable situation.

One post-termination effect that the owner needs to consider is its choice of replacement contractor. The owner should choose a replacement contractor in good faith and without incurring unnecessary costs. Since the original contractor may likely bring legal action for wrongful termination and payment for its claimed services, the owner's replacement contractor should complete the original project for an amount close to the original contract scope and sum. If costs to complete the contract exceed the amount owed to the terminated contractor, then the terminated contractor will claim that the owner increased the scope of work after termination or that the owner failed to mitigate the costs to complete. Both of these arguments can be used to defend against the owner's claim that it does not owe the contractor any of its claimed costs, expenses and damages. Thus, if the replacement contractor completes the project for an amount close to the original contract sum, these arguments would be unavailable to the contractor. The court, then, might be more inclined to find in favor of the owner and decline to award the contractor the damages sought.

Another post-termination effect to consider is a claim for wrongful termination. In the event an owner wrongfully terminates a construction contract, then the owner has materially breached the contract. If wrongful termination occurs, the contractor likely will sue the owner for breach of contract and seek damages. The effects of such litigation can be devastating.

Under such a breach of contract action, the contractor may recover for the reasonable value of work performed or the agreed price for full performance, less the cost of completing performance. Damages may include proper payment, interest and consequential damages. Consequential damages, if provided for in the contract or contemplated by the parties during the contract's negotiations, could include the contractor's lost profits due to its termination and the profits lost on other projects the contractor could not work on while it worked on the owner's project. Such a lawsuit, depending on the size of the project, could continue for years after the project's completion and likely would bring the project's total cost over budget because of attorney's fees and court costs, not to mention the time it will take away from the owner's productivity. Wrongful termination also may cause the owner to incur expenses to locate and obtain a replacement contractor, an extension in the project's completion time, damage to the owner's reputation among contractors and the community, and an open door to mechanic's liens by the unpaid general contractor and its subcontractors.

Ultimately, when a troublesome contractor drives an owner to termination, the original contractor's negative impact may not end with its termination. An owner should carefully weigh the potential impact of its post-termination choices and possible litigation.

Conclusion

Termination is a drastic sanction and should be treated as such. Even if an owner conscientiously follows all of the five steps discussed above, as well as all the steps required in the owner's particular construction contract, it is possible to be accused of wrongful termination. If that occurs, the owner may be forced to expend a tremendous amount of resources to defend the termination action. Thus, an owner should tread carefully when deciding whether or not to go down the termination path.

However, if an owner believes that termination is the only viable remedy to complete its construction project efficiently and expeditiously, and the owner can properly terminate the contract, then the owner should follow the procedures to terminate provided for in its contract plus take all of the following steps: (1) perform its obligations under the contract; (2) put observations in writing; (3) provide the contractor an opportunity to cure; (4) receive certification from the architect and/or engineer; and (5) provide contractual notice of termination.

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Controlling CAM Charges

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Many commercial tenants are shocked when they receive a rental statement or a supplemental rental statement from their landlords, which includes a significant charge for "CAM charges." CAM charges consist of common area maintenance (CAM) charges that are "passed through" to the tenant.

This article will examine a few of the key pass-through items, assuming that the tenant has already signed a lease. Many other provisions can and should be addressed in the course of negotiating such provisions.

It is important to realize that the goal of pass-throughs is to shift payment obligations from the landlord to the tenant. It is also important to realize that the obligation of the tenant to pay is solely a function of what the parties have agreed to, as reflected in the lease. When entering into a new lease, it is extremely important for the tenant to read the pass-through provisions closely (as well as the rest of the lease). More often than not, the provisions will be broadly drafted, with the objective to sweep in as many expenses as possible into those charges permissibly charged to the tenant.

If there are far-reaching pass-through provisions, is there nevertheless relief for the tenant? A lease is both a conveyance of an interest in real property as well as a contractual agreement. California law imposes on both parties a covenant of good faith and fair dealing in commercial transactions. A landlord will not be permitted to act in violation of that covenant. If the lease provision is not clear on what is included as a permissible pass-through, extrinsic evidence on what constituted the agreement of the parties is permitted to clarify the issue. If still unresolvable, ambiguities or uncertainties are interpreted to the disadvantage of the drafter, which is almost always the landlord.

While there are literally hundreds of charges that can be included in pass-throughs, this article focuses on a few of the more commonly disputed pass-throughs. While pass-throughs are clearly present in office buildings, even stand-alone buildings and shopping centers are often subject to pass-throughs.

Maintenance/Capital Charges

Many people would agree that items of a capital nature should not be included in a pass-through. What constitutes a capital expense is controversial. IRS guidelines should not be dispositive, nor should BOMA (Building Owner's and Manager's Association) guidelines.

GAAP (general actuarial and accounting principles) defines capital expenditures as those expenditures with a useful life of over one year. Clearly, that is not real estate industry standard. The Statement of Financial Accounting Concepts restricts maintenance and repair items to those items that do not improve, enhance or extend the life of the item. There are many gray areas in applying that standard: How should cost-saving capital expenditures be treated? What about government-mandated ones? An easy way for a landlord to pass through capital expenses is to lease the item rather than purchase it. Leasing expenses, even for capital items, clearly are a current operating expense.

Should leased items properly be a pass-through? It is not uncommon for landlords to include as a maintenance and repair item repairs for the benefit of a particular tenant, the cost of which is borne by all. Is it appropriate when the repaired item is an over-standard tenant improvement the landlord obligated itself to provide to that tenant? Is *it ever* appropriate? Another common pass-through is maintenance reserves. Is that ever appropriate, and if so, at what level?

Does the pass-through portion decrease as the lease term declines? A tenant will want to exclude those items specifically from the definition of CAM charges by use of a clause such as the following: "Specifically excluded from common area maintenance charges are installation of, or repair of, tenant improvements, or any reserves for maintenance or repairs."

Parking Garage Expenses

Buildings often run their parking facilities for guests of the building as well as other members of the general public. The operating costs of that business endeavor are often included as part of the operating costs, thereby allowing for a greater "profit" for the benefit of the building. Whether tenants ought to be subsidizing the operations of the building through pass-throughs is a thorny, frequently asked question. The parking costs passed through are wide ranging, including a portion of insurance premiums, salaries, benefits, utilities, maintenance and repairs, and the like.

Reimbursable Items

Whether by design or neglect, items are often included in pass-throughs notwithstanding that there is a right to reimbursement from others for such charges, and even notwithstanding that those reimbursements may actually be received. Equipment warranties or additional items separately charged to other tenants often get "double collected." This is a common problem, and one that is fairly easily discoverable by thorough review of the lease.

Leasing Expenses

Often included as pass-through items are lease commission charges, hard pass-through expenses of leasing agents, advertising and promotional fees, space planning costs, and standard tenant improvements to the new tenants. Sometimes included are over-standard tenant improvements and even sale commissions if the lease to a major tenant has an option to purchase and the commission agreement covers such an event.

Management Fees

Many leases have a fixed management fee (a fee based on percentage of revenues raises additional questions, not addressed here). In those instances, charges related to management of the building should not also be included as additional pass-through items. Many times they are.

Many landlords own multiple buildings. The allocation of the costs of administrative salaries should be closely monitored. A tenant could be charged for expenses incurred in managing other buildings, or in managing the managers. Typically included in pass-throughs, but perhaps not contemplated by the tenant, are headhunter recruiting fees, year-end bonuses, generous salary increases, "friendly" inflated salaries, benefits, professional dues and convention expenses, entertainment, training, management parties (e.g., Christmas), legal fees incurred in relationships with other defaulting tenants, accounting fees in monthly and year-end accounting reports, and income tax preparation. A tenant will want to exclude, or cap, those items from the definition of common area charges, perhaps as follows: "Specifically excluded from common area maintenance charges are all costs and expenses, including legal fees, incurred in enforcing rights or remedies against defaulting tenants, accounting and audit fees and expenses, bonuses to managers or employees, meals or entertainment expenses for managers or employees, and any increases in employee or manager compensation in excess of 4%, in the aggregate."

Utilities

If separately metered, utility charges are usually not controversial. Most leases require a tenant to pay a fixed percentage of the utility charges. However, should the landlord back out of the utility bill that portion of the utility charges used by the building's management offices? Should "overuse charges" reimbursed by other tenants be backed out? What about the utility charges incurred by retail operations in the building? What about the parking lot with charged public use? What about that portion of the utility bill representing exterior building lighting not related to safety (i.e., spotlights to make a visual statement or holiday lighting)?

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Of Interest

Articles

Connery, Nancy Ann, "Negotiating Commercial Leases: How Owners and Corporate Occupants Can Avoid Costly Errors. Current Issues: Impact of Bankruptcy on Commercial Leases," 458 *PLI/Real* 723 (May 2000).

Singer, Robert M., "Zero Down and Zero Later—The Problem of Collection: A Comparison of Procedures under State Collection Law, the Bankruptcy Code and the Internal Revenue Code," 105 *Com.L.J.* 159 (Summer 2000).

Tractenberg, Craig R., "What the Franchise Lawyer Needs to Know About Bankruptcy," 20 *Franchise L.J.* 3 (Summer 2000)

Cases

Bankruptcy

A member of the debtor's sister limited-liability company sought reconsideration of the order authorizing sale of the debtor's real property. The court found that the operating agreement for the limited-liability company was not an executory contract in which an *ipso facto* clause would be unenforceable under the bankruptcy statute. *In re Garrison-Ashburn, L.C.,* 253 B.R. 700 (Bkrtcy. E.D.Va. 2000).

A lessor sued the trustee to recover the debtor's share of real estate taxes owed under an unassumed lease. The court held that the lessor was entitled only to those taxes that accrued post-petition, but was entitled to interest at the contract rate of 12 percent, as well as $200 in attorney's fees. *In re Learningsmith, Inc.,* 253 B.R. 131 (Bkrtcy. D. Mass. 2000).

A landlord in a Chapter 11 case, which was converted to a Chapter 7 case, sought an order directing release of the debtor's funds to satisfy the levy on its writ of execution. The court held that the landlord did not have a superpriority claim under the bankruptcy statute, which required prompt performance of the debtor's obligations under an unexpired lease. *In re LPM Corp.,* 253 B.R. 914 (Bkrtcy.S.D. Cal. 2000).

In an action by a Chapter 11 landlord to compel immediate payment of post-petition, pre-rejection rent, the court held that the requirement that the trustee timely perform all the debtor's obligations under an unexpired commercial lease did not entitle a landlord to immediate payment of post-petition, pre-rejection rent from an administratively insolvent estate. *In re Microvideo Learning Systems,* 254 B.R. 90 (S.D.N.Y. 2000).

Brokers' Commissions

A lessor signed a brokerage agreement for a 10-year lease with an out-of-state corporation and paid half the commission up front, the rest to be paid over the first 12 months of the lease. The lessee defaulted and the lessor sued both its own broker and the lessee's out-of-state brokers for return of the commission. The trial court granted the lessor's motion for summary judgment on the grounds that the contract with brokers unlicensed by the state was void *ab initio.* The appellate court reversed, saying that it was premature for the trial court to find unjust enrichment of the brokers. The appellate court found that the lessor had not proved there were no facts in dispute with regard to the cause for enrichment and the existence of remedies at law. The lessor may have known about the potential nullity of the contract with unlicensed brokers and, thus, would be precluded from recovering under the contract. In addition, the court found it "incredible" that the lessor would enter into a sizable contract with an out-of-state corporation and not have some recourse if the corporation defaulted. Moreover, the court thought it "inconceivable" that the lessor would voluntarily pay a 10-year commission upfront without any recourse in the event of a default. It, therefore, reversed summary judgment for the lessor and remanded for trial. *Pique Severn Ave. Ptrshp.* v. *Ballen,* 773 So. 2d 179 (La.Ct.App., Stn Cir, 2000).

Contracts

A lessee assigned its assets under an agreement that did not specifically mention the security deposit for the leased premises. When the lessee later assigned its lease, a dispute arose regarding ownership of the security deposit. The state supreme court acknowledged that the intent of the parties could not be determined from the documents. However, the record from the lower court revealed that the lessee carried the security deposit as an asset of the business. The high court thus concluded that the intent of the parties was that the lessee retain its rights to the leased premises and assign its interest in the security deposit as part of the general transfer of assets. *Cantor Fitzgerald Inc.* v. *Cantor Fitzgerald Securities,* No. 136, N.Y., November 28, 2000.

Cost Recovery Services, Inc. (CRS) had an agreement with Price Waterhouse (PW), stating that if it found a mistake in the measurement of its leased premises and successfully obtained a rent reduction or other economic benefit for PW, CRS would receive 50% of that benefit. CRS claimed that PW's landlord had erroneously included space from the building's common area in the net rentable area. PW said that there was no error, and CRS sued for negligent misrepresentation and breach of contract. The trial court granted PW's motion for summary judgment on both causes of action and CRS appealed, arguing that PW had not addressed the negligent misrepresentation claim in its motion for summary judgment. The appellate court agreed, holding that even though breach of contract and negligent misrepresentation both shared the same element of proximate cause, summary judgment on one did not support summary judgment on the other. However, the appellate court upheld summary judgment, dismissing the contract claim on the grounds that CRS was neither a party nor a third-party beneficiary of the lease contract between PW and its landlord and, therefore, could not contest the construction of the lease. *Cost Recovery Services, Inc.* v. *Price Waterhouse,* No. 14-98-00917-CV, Tex.Ct.App., 14th Dist. Houston, Oct. 12, 2000.

Covenants/Clauses

A repair clause in a lease required that the premises be surrendered in as good a condition as they were at the commencement of the lease term. After a tenant vacated the leased premises, the landlord sued the tenant and guarantor for rent, taxes and repair costs. A judicial hearing officer (JHO) awarded the landlord the cost of replacing the roof and installing a sump pump system. The appellate court reversed. It held that the tenant was not obligated to return the premises in a condition better than it was at the commencement of the lease. Thus, the landlord could not be awarded any more than the cost of repairing the roof and none of the cost of installing the sump pump because those repairs would put the premises in a better condition than they were when the lease was executed. *Centre Great Neck Co.* v. *Penn Encord, Inc.* 276 A.D. 2d 735, 715 N.Y.S. 2d 71 (2d. Dept. 2000).

A reverse radius restriction barred the landlord from using any land within a one-mile radius of the shopping center for the manufacture or sale of donuts, pies or bakery products. The landlord and the adjacent landowner sold their land to a supermarket with an in-house bakery. Even though the bakery was located on the adjacent property owner's land, the court held that the store was subject to the reverse radius restriction and the owner had violated it. *Mabros* v. *Donuts-R-Us, Inc.,* 245 Ga. App. 73. 536 S.E. 2d 215 (Ga.Ct.App. 2000).

A shopping center lease for Norstan Apparel Shops contained an exclusive covenant not to lease to stores that sell "ladies' popularly priced apparel." When the landlord's successor leased to CATO, a competitor, the landlord filed a declaratory judgment action, seeking a declaration that the exclusive did not apply because the language of the covenant referred to payment of percentage rent and Norstan did not pay percentage rent. Norstan counterclaimed for breach of the covenant. The jury awarded damages to Norstan and the landlord appealed, arguing that Norstan presented only proof of lost profits and failed to provide evidence of damages for the decrease in the leasehold value. The appellate court reviewed the case law and held that lost profits were "material" to show the damages suffered. Moreover, said the court, other evidence had been presented. The landlord's expert on the leasehold value had admitted on cross-examination that the lease had decreased more than $21,000 in value. In addition, the CATO lease contained a remedy for breach of the exclusive covenant amounting to more than $25,000 per year. The jury could consider all this evidence to arrive at the award for diminished leasehold value. The appellate court, therefore, affirmed the award of damages and litigation expenses to Norstan. *Schreiber Co.- Shurlington Plaza, LP* v. *Norstan Apparel Shops of N.Y.,* 247 Ga.App. 145 (Ga.Ct.App. 2d Div., 2000).

Fees

A village had authority to impose impact fees, but it could not use a new ordinance to impose those fees retroactively in violation of the terms of a subdivision development agreement with the developer. *Country Meadows West Ptrshp.* v. *Village of Germantown,* 614 N.W. 2d 498 (Wis.Ct.App. 2000).

Guarantors

A landlord sued a restaurant tenant and its guarantors for unpaid rent. The original tenant had surrendered its franchise to a corporation that would operate the restaurant, but the original tenant would remain liable under the lease. One of the corporate shareholders signed a personal guarantee but later sold his shares without obtaining a release from the guarantee. The corporation subsequently returned the restaurant to the original tenant, who ceased paying rent. The landlord sued to recover unpaid rent and possession without termination of the lease. Prior to obtaining a judgment for possession, the landlord changed the locks and notified all parties. The tenant and guarantors claimed termination by forcible entry. The guarantor who sold his shares argued that he should not be liable. The court rejected all arguments and held the tenant and guarantors liable. However, because of the landlord's conduct in re-entering, changing the locks and expelling the tenants without a judgment, the court held that the lease had been terminated and no rent was due after the landlord reentered. *King* v. *Ston Investments,* CA 00-352, Ark.Ct.App., Div. 4, Dallas, Nov. 8, 2000.

Insurance

A tenant had an insurance policy that provided coverage for the landlord as an owner or lessor of the premised leased to the tenant. The policy also required written notice of any changes affecting the lessor or of termination of the coverage. The tenant sought to terminate its lease and signed an agreement to terminate. Over two months later, the leased premises were damaged by fire and the lessor filed a claim against the tenant's insurer. The insurer refused, saying that the fire occurred after the lease was terminated and the policy no longer covered the premises. The landlord sued the insurer, but the court granted the insurer's motion for summary judgment and the landlord appealed. After rejecting various grounds of appeal for not being raised below, the appellate court found that the lease had been terminated under an agreement with the landlord and that notice was required only if the policy was canceled by the insured or additional insured. Because the landlord had failed to raise a fact issue regarding its coverage under the policy, the appellate court affirmed summary judgment for the insured. *RNA Investments, Inc.* v. *Employers Ins. of Wausau,* No. 05-99-01704-CV, Tex.Ct.App., 5th Dist., Dallas, Nov. 16, 2000.

Landlord & Tenant

After the landlord sold the leased premises, the rent increased significantly. The tenant paid the first increase and then paid the amount of rent due before the increase. The landlord notified the tenant of its deficiency and then served an eviction notice, and filed a suit for restitution, unpaid rent and other damages. The tenant alleged that the landlord had waived its rights by accepting rent, and that the tenant had a right of first refusal on the property and had not been notified of the change in ownership. The court considered the tenant's defenses and granted the landlord's motion for summary judgment. On appeal, the court held that only the lower court's order for possession was reviewable. It found that the landlord had never waived its rights because it had notified the tenant of the deficiencies and its intent to terminate the month-to-month tenancy. The appellate court thus affirmed the judgment for possession and remanded for consideration of the remaining causes of action. *Edgbarton Investment, Inc.* v. *Target Expediting, Inc.,* Court of Appeals No. L-99-1410, Ohio Ct.App., 6th App. Dist., Nov. 17, 2000.

A lease had no option, and the landlord and tenant tried unsuccessfully to negotiate the terms of a new lease. There were proposals and modifications, but no document was signed. The landlord revoked its final lease offer, saying that the tenant could tender another offer. Nothing was executed and the tenant remained in possession, paying an increase in rent reflected in the unsigned lease. The landlord never negotiated the checks and eventually sued to recover possession of the premises. The trial court granted the landlord's request. In addition to possession, the appellate court affirmed the award of utility bills, interest and expenses. The court held that the tenants were clearly liable for the expenses and that the unsigned lease bound them, as holdovers, to all the terms in the lease. Furthermore, if the landlord had deposited the rent checks, it would have received the interest, but the landlord could not do this because it would have jeopardized its cause of action. *New Country Development Group, Inc.* v. *Demitasse, Inc.,* 718 N.Y.S. 2d. 107 (3d Dept. 2000).

Leases

A 10-year lease for a billboard was terminable by six months' advance written notice. The landlord sent a letter purporting to terminate the lease, and the parties began to negotiate for a renewal. During the period in which they could not agree on terms, the landlord allegedly permitted a third party to use the billboard to advertise, and the tenant sold its stock to another corporation, Outdoor Systems, Inc. Outdoor then sued for a declaratory judgment that the lease had been renewed. The landlord argued that the corporation had no standing to sue because it was not a party to the contract. The trial court agreed, but the appellate court reversed in part. It held that the lease contemplated assignment by its terms and the landlord had consented in advance to any assignment. Thus, Outdoor had standing to assert that the lease had been renewed. The appellate court examined the record and decided that there were questions of fact regarding the termination and renewal of the lease and remanded for trial on those issues. *Outdoor Systems, Inc.* v. *Wood,* 247 Ga.App. 287 (2d Div. 2000).

Less than one year after signing a five-and-a-half-year lease, the tenant restaurant sought to negotiate a termination. When it was unsuccessful, it sold or removed most of its equipment and disconnected its phone. The landlord changed the locks and the tenant filed suit for wrongful eviction. The trial court granted the tenant's summary judgment motion for wrongful eviction and dismissed the landlord's counterclaim for rent due. The landlord appealed and the appellate court determined that in these circumstances the doctrine of anticipatory breach applied. The landlord had not fully performed its obligation by turning the premises over to the tenant. The lease imposed continuing obligations on the landlord—e.g., the repair and maintenance of structures and common areas. Thus, the appellate court found that the lease contained mutually interdependent contractual obligations, which required that the doctrine of anticipatory breach not be rejected as a matter of law. The record revealed an "unequivocal intent to forgo performance" by the tenant. Therefore, the appellate court reversed and remanded for a hearing on the landlord's damages. *Pitcher* v. *Benderson-Wainberg Associates II Ltd. Ptrshp.,* 715 N.Y.S. 2d 104 (3d Dept., 2000).

A lease provided that double rent be paid if the tenant held over without the landlord's consent. The landlord and tenant negotiated for a renewal but could not agree, and the tenant continued to occupy the premises at the old rent. The tenant vacated and the landlord sued to recover the remainder of the double rent. The trial court dismissed the landlord's action and the appellate court affirmed. It found that there was no evidence to prove that the tenant continued to occupy the premises without the landlord's consent and that the double-rent provision was thereby triggered. The appellate court also found that drafts of earlier leases in which the double rent provision applied when the tenant held over with or without the landlord's consent were relevant to the interpretation of the double-rent provision. *Shore* v. *Best Cuts, Inc.,* No. 77340, Ohio Ct.App., Eighth App. Dist., Cuyahoga County, November 30, 2000.

A tenant sued for breach of contract and fraud, based on misrepresentations made by the landlord and its agents to the tenant's incorporators during lease negotiations before the tenant was incorporated. The landlord said that it had a lease with TGI Fridays and would be renovating the shopping center, erecting a pylon sign and replacing the vacant anchor tenant. The lease with Fridays fell through and the landlord did not renovate, erect the sign or replace the anchor. Nevertheless, the tenant continued to operate and made improvements in an effort to compete with other newly opened restaurants. After two failed efforts to sell the restaurant, the tenant ceased to pay rent and the landlord evicted it. The tenant filed suit, but the trial court found that it did not have standing to sue because it was not in existence when the representations were made. Moreover, the tenant did not rescind the contract when it discovered the fraud but, by its conduct, affirmed the contract. Thus, it was bound by the terms of the contract, which contained a merger clause. Consequently, none of the representations could be the basis of a suit because the lease specifically stated that it superseded all representations, whether oral or written, between the parties or their representatives. *Skipper Sams* v. *Roswell-Holcomb Assoc.,* 247 Ga.App. 237 (3rd Div. 2000).

Mitigation of Damages

In a breach of lease suit by a landlord against a vacating tenant, the landlord appealed the trial court's decision denying a month's rent because the landlord failed to mitigate its damages. The appellate court reviewed recent case law regarding a landlord's duty to mitigate. It decided that the trial court's decision was based on substantial evidence. The court found that the landlord should have considered dividing the space, advertising locally as well as nationally, and should not have failed to respond to an inquiry by an adjacent tenant who wanted to expand. The court noted that the landlord's efforts were "geared more toward efforts for leasing space in a new mall" rather than for a 30-year-old mall. Based on testimony from the leasing company, it found that the landlord's priority was to have the mall leased and not to fill vacancies. The appellate court also held that the trial court's decision did not raise the standard of reasonable mitigation of damages for a commercial premises. *Leavenworth Plaza Assoc. LP* v. *L.A.G. Enterprises,* 16 P. 3d 314 Kans.Ct.App. 2000).

Options

A lease contained a right of first refusal to purchase the building. An offer was submitted, which the landlord signed but never returned to his Agent or communicated acceptance to the offeree. The Agent sent a letter to the tenant to notify the tenant of the offer, and the tenant accepted. However, the landlord repeatedly refused to honor the tenant's exercise of the option. The tenant sued for specific performance and won. The landlord appealed. The appellate court held that the conduct of the landlord and its Agent indicated that a right of first refusal existed. The right is triggered, even if the landlord does not enter into an actual purchase agreement and even if the dates contained in the third party's offer to purchase have passed. *Electric Fetus Co., Inc.* v. *Gonyea,* C1-00-545, Minn.Ct.App., filed Nov. 21, 2000.

A lease provided that the lessee could sublease any part of the premises without the landlord's consent but must have the landlord's consent to sublease the entire premises. The lessee assigned the premises, and the assignee sublet the building and all but a small parcel of the premises without obtaining the landlord's consent or notifying the landlord as required by the lease. When the sublessee sought to exercise its option, the landlord objected on the grounds that the assignee had violated the lease by not getting consent to the sublease. The assignee and sublessee sued and won summary judgment. The landlord appealed and the appellate court affirmed, finding that the lease clearly did not require approval for sublease of a portion of the leased premises, even if that portion was *"de minimis"* and designed to avoid the consent requirement in the lease. Furthermore, the violation of the notice requirement was not a material violation and did not deprive the landlord of any material benefit that would be sufficient to divest the assignee/sublessee of the right to exercise the option to renew. *Holytrent Properties, Inc.* v. *ValleyPark Ltd. Ptrshp.,* 71 Ark.App. 336 (Div. One), 325. W. 3d. 27 (Ark.Ct.App.Div. One 2000).

A lease contained an option to purchase if the tenant were not in default at the time of exercise. The landlord claimed that the tenant had failed: to provide certificates of insurance for business interruption insurance, to reimburse the landlord for the cost of fire and casualty insurance, to obtain written consent for alterations of the premises, to obtain building inspections for the alterations and to reimburse the landlord for attorneys' fees incurred in enforcing the lease. The trial court granted summary judgment for the landlord but the appellate court reversed, holding that there were questions of fact and conflicts in the evidence regarding whether the tenants had timely procured the insurance and reimbursed the landlord for the fire and casualty insurance. Quoting from relevant case law, the court noted that not every breach justifies cancellation of a lease. Moreover, the lease did not require inspection of the alterations, and there was proof the landlord may have waived its right to consent to alterations. Finally, if there were no default, the landlord would have no right to attorneys' fees. *Loomis* v. *Hamerah*, 538 S.E. 2d 593 (N.C.Ct.App. 2000).

A shopping center tenant signed an estoppel certificate when a new owner purchased the shopping center and informed the new owner that it wanted to renew its lease. The lease required that the tenant give notice of its intent to renew within one year of the lease termination date and the tenant wanted to exercise the option even though the deadline for notification of intent to renew had passed. The owner refused, and the tenant sued. It argued that the lease termination date in the estoppel certificate was incorrect and did not give the tenant sufficient time to renew. But the court held that the tenant was bound by the estoppel certificate and could not exercise the option. *Plaza Freeway LP* v. *First Mountain Bank*, 81 Cal.App. 4th 616 (2000).

A tenant filed an action for a declaration that it had timely exercised its purchase option. The trial court held that the exercise was late, and the tenant appealed. The appellate court reversed, finding that a temporary restraining order tolled the period during which the tenant was required to exercise the option. *Syndicom Corp.* v. *Takaya,* 275 A.D. 2d 676 714 N.Y.S. 2d 256 (1st Dept. 2000).

An option in a lease was exercisable with six months' written notice. The agreement assigning the lease provided that the landlord would notify the lender of any default and give the lender an opportunity to cure. The tenant attempted to exercise the option by sending a letter to the landlord, who, unbeknown to the tenant, had died. The tenant then sent a letter to the landlord's successors, but received no response until they notified the tenant that the lease had expired and the month-to-month tenancy was being terminated. The lender sought unsuccessfully to renew the lease, and the landlord filed an action to evict the tenant. The trial court ruled in favor of the landlord, and the appellate court affirmed. It found that even the tenant's letter to the deceased landlord had been sent too late to exercise the option and the lender did not have to be notified of the tenant's failure to exercise the option because such a failure was not a default. *The Heirs of Zepherin Boudreaux* v. *Payne*, 773 So. 2d 894 (La.Ct.App. 3rd Cir, 2000).

Zoning

Off-site parking at a nearby garage did not satisfy an ordinance requirement for retail property to provide accessory parking spaces. The appellate court found that the zoning board's interpretation of the ordinance was incorrect and that its findings were against the manifest weight of the evidence. A license agreement with the garage did not reserve parking spaces for the exclusive use of the retailer. Because the spaces were not in the retailer's possession by deed or lease, the court held, the requirements of the ordinance were not met. *North Avenue Properties, L.L.C.* v. *Zoning Board of Appeals*, 312 Ill.App. 3d 182, 726 N.E.2d 65 (Ill.Ct.App. 2000).

Legislation

Maine—S.B. No. 1027. Maine established the Downtown Leasehold Improvement Fund to assist state agencies in securing suitable space in downtown areas and the Maine Downtown Center to advocate for revitalization.

Maryland—S.B. No. 507. Municipalities are authorized to grant property tax credits for property rehabilitated under guidelines adopted by the municipality.

From Canada
■ Judicial/LegislativeDevelopments

Cases

Federal

The Supreme Court of Canada ruled that there are several compelling policy reasons to preclude extending the tort of negligence into commercial negotiations. *Martel Building Ltd*. v. *Canada,* [2000] S.C.J. No. 60 (Supreme Court of Canada, November 30, 2000, McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie and Arbour JJ.)

ALBERTA

After the tenant abandoned its premises, the landlord was entitled to receive, as damages, rent for the unexpired term of the lease less any amounts received by the landlord as a result of re-letting the premises. *Vinet's Store (1973) Ltd.* v. *Video Update Canada Inc.,* [2000] A.J. No. 1153 (Alberta Court of Queen's Bench, September 27, 2000, Jones J.)

The owners of certain lands attempted to circumvent the municipality's subdivision controls by leasing two parcels for a term of 35 years. The municipality was granted an injunction on the basis that such conveyance was, in substance, a sale. The scheme violated the purposes of the *Land Titles Act* and the *Municipal Government Act* and, as such, the leases were void. *Strathcona (County)* v. *Half Moon Lake Resort Ltd.*, [2000] A.J. No. 615 (Alberta Court of Queen's Bench, May 26, 2000, Ritter J.)

BRITISH COLUMBIA

A landlord could not be found liable in connection with a fire that occurred in the common area of the mall on the grounds that the lease barred the mall's tenants from making a claim for contribution against the landlord. The lease covenants also extended to the landlord's employees, as they were simply performing the landlord's covenants under the lease. The City of Surrey could not seek compensation from the landlord for breach of the City's by-laws; as such, a remedy was not authorized by statute or the common law. *Laing Property Corp.* v. *All Seasons Display Inc.* (2000), 6 B.L.R. (3d) 206 (B.C.C.A.)

MANITOBA

The right to alter, expand, improve or diminish the mall was not explicit enough to permit the landlord to demolish the existing enclosed mall and replace it with a big box power centre. The landlord also breached the covenant to operate the mall as a first-class shopping centre due to the fact that the power centre was not a shopping centre of the size and type that had existed prior to the demolition. *Michael Santasieri Inc*. v. *Unicity Mall Ltd.,* [2000] M.J. No. 546 (Manitoba Court of Queen's Bench, November 22, 2000, Schulman J.)

Mould was found to be growing on the walls in the interior of the tenant's premises. The landlord undertook to rectify the situation. During the repair period, a portion of the space that was leased by the tenant was rendered unusable. Pursuant to the terms of the lease, the tenant was only entitled to a rent abatement. *Marvin Investments Ltd.* v. *Manitoba,* [2000] M.J. No. 495 (Manitoba Court of Queen's Bench, October 27, 2000, Krindle J.)

NOVA SCOTIA

The Nova Scotia Utilities and Review Board was called upon to review a joint decision of the Truro Town Council and Colchester Municipal Council, which had approved a development agreement for a shopping centre. The Board, *inter alia,* discussed the intent of the Shopping Centre Development Act (Nova Scotia) insofar as it relates to the public's right to be heard. *Re MillBrook Indian Band,* [2000] N.S.U.R.B.D. No. 125 (September 26, 2000)

ONTARIO

The landlord hired several police officers to erect barricades during the evening hours in order to prevent vehicle access to the parking lots of the building in which the premises were located. The landlord's actions constituted a fundamental breach of the lease, as the landlord effectively negated the commercial purpose of the lease and the tenant's benefit thereunder. *995988 Ontario Inc. (c.o.b. California Dreams)* v. *Shipp Corp.*, [2000] O.J. No. 3305 (Ontario Superior Court of Justice, September 1, 2000, Juriansz J.)

The lower court had not proceeded on an incorrect principle by requiring the tenant to adduce appraisal evidence to show that the landlord's mitigation efforts were not reasonable. *1039198 Ontario Inc.* v. *Ash Pharmacies Inc.*, [2000] O.J. No. 2523 (Ontario Court of Appeal, July 4, 2000, McMurtry C.J.O, Morden and Rosenberg JJ.A.)

By way of a letter agreement, the parties agreed to enter into a lease for an industrial building that was to be built by the landlord. The tenant subsequently took the position that there was no agreement. The landlord sought specific performance. Before trial, the landlord mitigated some of its damages by re-leasing the property. The tenant's motion for summary judgment was dismissed, as the tenant had not satisfied the onus of establishing that there was no genuine issue for trial. *117577 Ontario Ltd.* v. *Magna International Inc.* (2000), 50 O.R. (3d) 579 (Sup. Ct.)

The tenant's actions did not amount to a breach, or an anticipatory breach, of an offer to lease, as its conduct did not amount to a total rejection of its obligations under the offer to lease. The tenant was merely continuing to negotiate acceptable terms where there had been no clear meeting of minds. *Bugle Construction Co.* v. *1237724 Ontario Inc. (c.o.b. F.P. Canada),* [2000] O.J. No. 3113 (Ontario Superior Court of Justice, May 31, 2000, Caswell J.)

The basic rent payable by the tenant during the renewal term was to be an amount equal to the basic rent payable by the tenant during the last year of the then-current term. The tenant claimed that in its negotiations with the landlord, the rate of basic rent was always discussed in terms of *effective* rent, taking into account several rent-free months. There was nothing in the words or conduct of the landlord that would have estopped the landlord from relying on the plain terms of the agreement. *Colonnade Development Inc.* v. *Aprel Inc.*, [2000] O.J. No. 2964 (Ontario Superior Court of Justice, August 2, 2000, Sedgwick J.)

The landlord expected that one of its office tenants would exercise its mid-term contractual termination right, based on conversations between the landlord's representative and the tenant's agent. Accordingly, the landlord proceeded to lease the tenant's space to a replacement tenant. The tenant subsequently decided against terminating the lease (before issuing a termination notice). The tenant sought an injunction restraining the landlord from interfering with its right of possession under the lease. The injunction was refused on the grounds that the landlord would bear the greater degree of harm. *Computer Science Canada Inc.* v. *1142543 Ontario Inc. (c.o.b. as K.D. Financial Services Ltd.)*, [2000] O.J. No. 4269 (Ontario Superior Court of Justice, November 3, 2000, Aitken J.)

While there are some circumstances in which there are obligations upon contracting parties to act in good faith (e.g. , the exercise of a discretion, the duty to use best efforts), in contractual negotiations "each party is entitled to act in accordance with its own interests." *EdperBrascan Corporation* v. *117373 Canada Ltd.* (2000), 50 O.R. 3d 425 (Sup. Ct.)

The landlord's distraint over equipment that was owned by an equipment lessor, and in which the tenant had little, if any, equity, was subordinate in rank to the claim of the equipment lessor. *Honey Grove Estates Inc.* v. *AT &T Capital Canada Inc.*, [2000] O.J. No. 4147 (Ontario Court of Appeal, November 6, 2000, Finlayson, Carthy JJ.A. and Simmons J.)

The landlord could not terminate the lease and then distrain upon the goods of the tenant for unpaid rent. *Imber* v. *Rados*, [2000] O.J. No. 3122 (Ontario Superior Court of Justice, August 18, 2000, Fedak J.)

An operating covenant was not an implied term of the lease, as no clear intention was found to support the requirement. *Key Trey Holdings Inc.* v. *Clarica Life Insurance Co.*, [2000] O.J. No. 3109 (Ontario Superior Court of Justice, June 20, 2000, Donnelly J.)

The owner of equipment agreed with a tenant of commercial premises to allow the tenant to place the equipment in the leased premises, operate it and share the revenue with the owner on a 50-50 basis. The equipment owner was not a tenant and, therefore, the landlord was not entitled to distrain the equipment. *Khan* v. *Calverley*, [2000] O.J. No. 4181 (Ontario Superior Court of Justice (Divisional Court), November 6, 2000, O'Driscoll J.)

The lease provided that the landlord could terminate the lease if the landlord proposed to "substantially remodel" the building to an extent that rendered the continued occupation of the premises "impracticable." The cost and inconvenience of having to work around the tenant was excessive and, as such, the tenant's continued occupation of the premises was impracticable. *Kingclip Holdings Inc.* v. *Novak Graphics Inc.,* [2000] O.J. No. 3723 (Ontario Superior Court of Justice, October 5, 2000, Molloy J.)

Oral discussions that had taken place between the parties amounted to a contractual relationship for a fixed three-year term. *Manitouwadge General Hospital* v. *Kudlak,* [2000] O.J. No. 3515 (Ontario Superior Court of Justice, September 18, 2000, Kozak J.)

The landlord terminated the lease by changing the locks, notwithstanding that the keys were returned to the tenant later that same day and the tenant remained in possession for several months thereafter. However, by transferring all the tenant's assets to a new corporate entity, the tenant's principal exercised his powers in an unfair manner and disregarded the interests of the landlord. As such, the landlord was entitled to restitution pursuant to the oppression remedy available under the *Business Corporations Act* (Ontario). *Novacrete Construction Ltd.* v. *Profile Building Supplies Inc.,* [2000] O.J. No. 3179 (Ontario Superior Court of Justice, February 11, 2000, Himel J.)

The *Retail Business Holidays Act* was held to be constitutional. The Act prohibits a person carrying on business in a retail establishment from selling or offering for sale goods or services, at retail, on a holiday (which the Act defines as New Year's Day, Good Friday, Victoria Day, Canada Day, Labour Day, Thanksgiving Day, Christmas Day and Easter Sunday). The ruling in this case does not alter the law with respect to Sunday (except Easter Sunday) or Boxing Day shopping. These two particular days do not fall under the definition of "holiday" under the Act, and, accordingly, retailers are entitled to open for business on both of these days. *R.* v. *Hy & Zel's Inc.,* [2000] O.J. No. 4522 (Ontario Superior Court of Justice, November 30, 2000, McCombs J.)

Rents received by a commercial landlord fall within the scope of Section 7(3) of the *Construction Lien Act* (Ontario) and, as such, they constitute trust funds held for the benefit of contractors. The trust created under Section 7(3) is not restricted to the landlord's operating profits. *Structural Contractors Ltd.* v. *Westcola Holdings Inc. et al.* (2000), 48 O.R. (3d) 417 (C.A.)

A neighbouring tenant was a source of constant annoyance and inconvenience for another tenant of the property. However, the conduct was not serious enough to constitute a breach of the covenant of quiet enjoyment nor a fundamental breach of lease on the part of the landlord. *Sun Life Assurance Co. of Canada* v. *Pentex Print Master Industries Inc.,* [2000] O.J. No. 3180 (Ontario Superior Court of Justice, March 6, 2000, Molloy J.)

A renewal provision was void for uncertainty, as it did not indicate who had the right to exercise the option, when the option was to be exercised or how it was to be exercised. The renewal provision was also found to be ambiguous. *The contra proferendum* principle dictated that such ambiguity should be resolved in the tenant's favour due to the fact that the letter agreement had been drafted by the landlord. *Unique A T Holding Corp.* v. *Bryson & Associates Insurance Brokers Ltd.,* [2000] O.J. No. 4313 (Ontario Superior Court of Justice, November 10, 2000, C. Campbell J.)

QUEBEC

A mortgagee elected to insure a property and recovered the premiums from the mortgagor on a monthly basis. The mortgagee did not advise the mortgagor that the building was insufficiently insured. When the property was destroyed by fire, the mortgagee sought to recover the balance of the loan from the mortgagor and guarantor. The mortgagor and guarantor were released from their obligations under the agreement due to the fact that the mortgagee had been negligent in not advising of the insufficient insurance. *Assurance-Vie Desjardins - Laurentienne* v. *2744-3149 Quebec Inc.,* 500-05-029825-971 (JE 2000-1858)

Where a mortgagee of the rights of an emphyteutic lessee elects to become the "emphytéote" following a default under the loan, the mortgagee becomes liable to pay all the amounts due under the Deed of Emphyteusis. The mortgagee is treated, for all intents and purposes, as being the owner of the property vis-à-vis the emphyteutic lessor. *Sun Life Assurance Co. of Canada* v. *137578 Canada Inc.*, 500-09-006000-988 (JE 2000-2005)

A municipality that supplies electricity under the *Hydro Quebec Act* has a superior claim against real property in connection with any outstanding arrears. *Caisse Populaire d'Amos* v. *Café de Quai* (1994) Inc., 605-05-000476-999 (JE 2000-1648)

The Quebec Superior Court had ordered the demolition of a Loblaws supermarket that was not built in compliance with municipality zoning by-laws. The by-law required greater density than that provided by the supermarket. The Superior Court had refused to accept that the development was to be constructed in phases and that the completed project would meet the requisite density requirements. The Court of Appeal reversed the Superior Court's decision in part. In the Court of Appeal's view, the phased development plan was not a sham. The Court ordered Loblaws to be in compliance with the by-law within two years. *Loblaws Québec Ltée* v. *Alimentation Gérard Villeneuve* (1998) Inc., 500-09-009388 (JE 2000-1930)

A purchaser of certain real property acted in bad faith. The purchaser offered to buy two lots. The purchaser subsequently amended the offer by adding a third lot, but did not bring the amendment to the vendor's attention. Upon discovering that a third lot was included in the offer, the vendor refused to conclude the transaction. The purchaser unsuccessfully sought damages and an order for specific performance. *Cam-Spec International Inc.* v. *Dominion Textile Inc.,* 760-05-001333-960 (JE 2000-2003)

Petro Canada sold a piece of property on an as-is and without warranty basis. However, Petro Canada informed the purchaser that the site had been decontaminated to meet the requirements of the Ministry of the Environment. Petro Canada was ordered to pay damages, as the land did not meet Ministry requirements. *Mabaie Inc.* v. *Petro Canada Inc.,* 500-05-030557-977 (JE 2000-2203)

A franchisor was entitled to retain a deposit that had been paid by a prospective franchisee. The franchisee sought to terminate the agreement after it failed to find suitable financing. The franchise agreement was not a contract of adhesion nor could the deposit be considered a penalty. *Gestion Jeroden Inc.* v. *Choice Hotels Canada Inc.,* 550-17-000244-986 (JE 2000-2175)

A franchise agreement was cancelled, and the franchisor was awarded damages for arrears of royalties and rentals. The tenant argued that it was not responsible for these amounts, as the franchisor had made false representations in connection with the viability of the franchise. *Restaurant E.S.R. Inc*. v. *Restaurants Prime du Quebec Inc.,* 500-05-025342-963 (JE 2000-2066)

The landlord relocated the tenant pursuant to a relocation provision contained in the lease. The landlord subsequently sought to relocate the tenant again. The tenant refused and left the shopping centre. It was the tenant's contention that the relocation right only applied once and that the new location was smaller and did not provide the same visibility as did the previous store. The evidence did not support the tenant's arguments. *Centre d'Achat Beauward Ltée* v. *Keuylian,* 700-17-000380-989 (JE 2000-1622)

A landlord was not entitled to recover the costs of replacing the roof from its tenant on the grounds that it was not a reasonable expense for the tenant to pay, as it was only a five-year lease. The landlord was also not entitled to charge the tenant an administration fee, as it was not expressly provided for in the lease. *Skyline Holdings Inc.* v. *Scarves and Allied Arts Inc.,* 500-09-001234-937 (JE 2000-1623)

A tenant was liable for arrears of rent and damages. It was the tenant's contention that it was not responsible for such amounts, as its subtenant had vacated the premises as a result of the disruptive manner in which the landlord had carried out repairs to the premises. The lease provided that the tenant would permit the landlord to effect all repairs without being entitled to a rent abatement. *Investissements Claude Séguin Inc.* v. *Bourgeois,* 550-05-000853-948 (JE 2000-1793)

The tenant unsuccessfully sought an order to terminate its lease on the grounds that the landlord had represented that its renovations would increase customer traffic in the shopping centre. The tenant should have included the representation in the lease if it intended to rely on it. *2928116 Canada Inc.* v. *9012-9842 Quebec Inc.,* 500-09-005826-979 (JE 2000-2125)

SASKATCHEWAN

A tenant was entitled to terminate his lease prior to the expiry of the term on the grounds that the landlord had made a representation to the tenant, prior to entering into the lease, which led the tenant to believe that he could terminate the lease if the tenant decided to relocate his medical practice. *Medical Arts Building Ltd.* v. *Awad* (2000), 192 Sask. R. 68 (Q.B.)

A secured creditor was found to have properly enforced its security. The creditor was not required to deliver a notice under s. 244 of the *Bankruptcy and Insolvency Act*, as there was no evidence that the debtors were insolvent. *Rathcliffe Holdings Ltd.* v. *Royal Trust Corporation of Canada*, [2000] S.J. No. 569 (Saskatchewan Court of Queen's Bench, September 6, 2000, Wright J.)

A grocery store breached the duty of care owed to one of its customers after the customer slipped and fell on a patch of water in one of the store's food aisles. As the area was susceptible to the accumulation of floor moisture, the store should have monitored the area at frequent intervals. *Wilson* v. *Westfair Foods Ltd.* (2000), 192 Sask. R. 317 (Q.B.)

A liquor store met the standard of care imposed by law and, therefore, was not liable for the injury suffered by one of its customers. The store had a reasonable maintenance program in effect. The customer had fallen on a patch of ice while exiting the store. *Zoltan* v. *Saskatchewan (Liquor and Gaming Authority)*, [2000] S.J. No. 611 (Saskatchewan Court of Queen's Bench, October 13, 2000, Kovach J.)

Legislation

NOVA SCOTIA

Electronic Commerce Act, S.N.S. 2000, c. 26—The Act, which recognizes the legal validity of electronic agreements and signatures, is very similar to the Ontario legislation described below.

Amendments to the *Consumer Protection Act*, S.N.S. 2000, c. 34—The legislation amends the *Consumer Protection Act* by adopting new provisions that regulate disclosure and advertising by lenders.

ONTARIO

Bill 119—*Red Tape Reduction Act, 2000*—This Bill, which received Royal Assent on December 6, 2000, makes minor amendments to several existing statutes and also enacts two new statutes. Highlights include: (i) a mortgagee may now provide a mortgagor with a fax copy (as opposed to true copy) of a mortgage agreement; (ii) a single financing statement may be registered to perfect more than one security interest arising between the same parties; and (iii) the *Building Code* Act has been amended to clarify that an appeal of an order or decision of a chief building official or inspector does not stay the decision or order.

Bill 124—*Toughest Environmental Penalties Act, 2000*—This Bill, which received Royal Assent on November 21, 2000, increases the fines and the maximum for administrative penalties set out under the *Ontario Water Resources Act*, the *Pesticides Act* and the *Environmental Protection Act.*

Bill 139—*Labour Relations Amendment Act, 2000*—The Third Reading of this Bill, which was debated on December 19, 2000, was carried on division on December 20, 2000. The Bill makes several changes to the *Ontario Labour Relations Act.* Highlights: (i) a one-year bar on any union seeking certification in some circumstances where a certification application has been withdrawn or dismissed; (ii) the "open period" for decertification is lengthened; and (iii) employers will be required to annually distribute a government prepared document outlining how an employee group may decertify.

Bill 140—*Continued Protection for Property Taxpayers Act, 2000*—The Act, which received Royal Assent on December 4, 2000, limits property tax increases to 5% annually, plus permitted municipal levy increases. The City of Toronto may maintain the 2.5% limit it chose in 1998 or it may move to the 5% provincial limit. The new caps will apply in 2001 and remain in effect until current value assessment is fully achieved in each municipality.

Bill 147—*Employment Standards Act, 2000*—The Third Reading of this Bill, which was debated on December 19, 2000, was carried on division on December 20, 2000. The Bill replaces the current *Employment Standards Act.* While many existing labour standards remain intact, the Bill makes notable changes relating to hours of work. For example, the Bill stipulates that employees can refuse work in excess of 48 hours per week without repercussion (up from the current 44 hours). The Bill also makes amendments to overtime eligibility, meal breaks and vacation time. Unpaid parental leave eligibility is increased to 35 weeks (up from the current 18 weeks).

Bill 33—*Franchise Disclosure Act, 1999*—Bill 33, which received Royal Assent on June 8, 2000, generally applies to franchise agreements entered into on or after the Act comes into force on January 31, 2001. The Bill includes: (i) a duty of fair dealing on each party to a franchise agreement; (ii) the right of franchisees to associate and form or join an organization of franchisees; and (iii) an obligation on franchisors to provide franchisees with disclosure documents and the ability of franchisee to rescind a franchise agreement under certain circumstances.

The Electronic Commerce Act, 2000, S.O. 2000 c. 17—The Act, which came into force on October 16, 2000, removes barriers to electronic commerce. The Act: (i) ensures that electronic documents are not denied validity or enforceability solely by reason of the fact that they are in electronic form; (ii) provides that an electronic signature satisfies the legal requirement that a document be signed or endorsed; (iii) allows parties to store a written document in an electronic format without affecting the binding nature of the document; and (iv) permits the use of electronic information or documents where there is a legal requirement to provide information or a document to someone in writing. The Act does not oblige persons to use electronic communications if they do not wish to do so (however, a person's consent may be inferred from the person's conduct). Leases may be effectively created through electronic communication. Also, notices under leases (exercising a renewal option, for instance) may be effectively sent by electronic means absent an express stipulation to the contrary. Landlords and tenants may wish to consider modifying their leases in order to address this issue.

QUEBEC

Bill 150—Property Taxation—Bill 150, enacted on December 21, 2000, allows municipalities to use variable mill rates and provides for a gradual elimination of the surtax on non-residential immovables, the tax on non-residential immovable, and the surtax on vacant serviced land.

Building Code—Quebec has adopted a new building code which brings about major changes relating to sprinkler, mechanical and ventilation systems as well as handicapped access to buildings. The new code is modelled after the National Building Code.

Environmental Regulation of Snow Removal—*Quebec's Environmental Quality Act* and the regulations adopted thereunder require developers to obtain authorization certificates prior to removing snow. Developers must also obtain detailed studies in connection with the environmental impact of dumping snow in a particular area.

Bill 156—Environmental Legislation—This Bill, which seeks to establish new rules for the protection and rehabilitation of contaminated land, proposes to make requests for land-use changes subject to clean-up programs.

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Shopping Center Legal Update

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