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Shopping Center Legal Update

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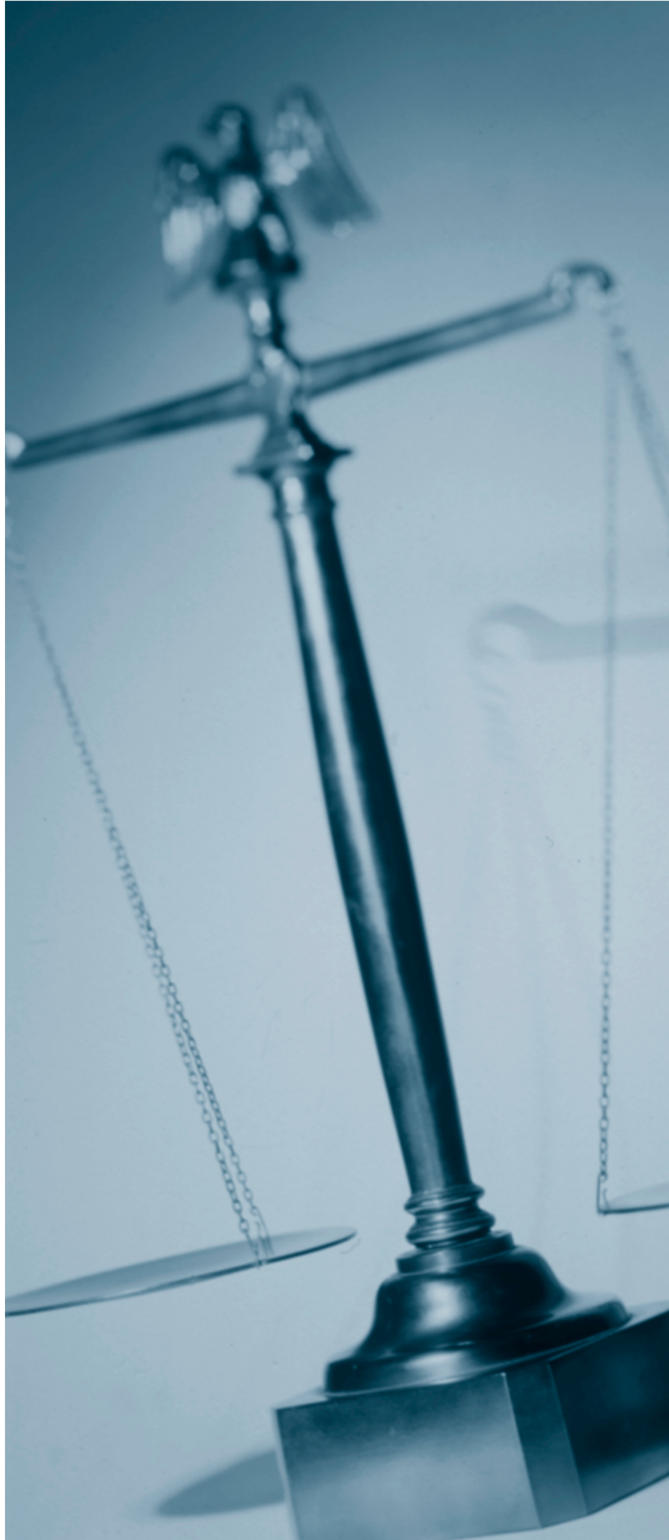

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Rejected Landlord Syndrome: Don't Get 'Stubbed Out' When Your Retail Tenant Files for Bankruptcy

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A recent bankruptcy case in Northern Ohio, *In Re: Snyder's Drug Stores*, presented a situation often confronted by commercial landlords when a retail tenant, usually a chain, falls upon hard times and files for bankruptcy. As some of the landlords in the *Snyder* case found, if your bankrupt retail chain tenant-debtor then seeks to reject your lease, don't be surprised if the debtor tries to avoid paying you rent for the balance of the month in which the filing occurs, as well as the pre-surrender portion of the month in which the debtor vacates the property. The rent for these partial month periods is quaintly referred to as "stub rent." If you don't watch out, you could get stiffed at both ends of the period of your involvement with the tenant's bankruptcy. However, with the exercise of vigilance, coupled with some able assistance, you may be able to avoid a serious shortfall.

This potential minefield for landlords arises out of the Chapter 11 bankruptcy reorganization system wherein the debtor is permitted to discard or "reject" those leases that it does not want to keep and to, instead, assume (i.e., keep) those leases that it wants to retain. Typically, the debtor will develop its reorganization strategy very early in the case, assume the leases of certain of the better retail locations and reject those of the less desirable locations. Rejection is essentially a premature termination of the lease, and while any obligations under an unexpired lease arising during the post-petition, pre-rejection period are supposed to be timely paid, this does not always happen—in which case, the landlord will usually need to take some affirmative action to stand up for its rights.

Another Northern Ohio bankruptcy case a few years ago, *Koenig Sporting Goods*—although dealing with stub rent during the rejection month (the "back end")—set the stage for retail tenant-debtors to try to avoid the petition month (the "front end") stub rent. That case upheld the entitlement of the landlord to a full month's rent where the lease payment came due on the first of the month, notwithstanding the fact that the retail tenant-debtor rejected the lease later that month. Since *Koenig*, retail tenant-debtors in bankruptcy have tried to use the *Koenig* rationale to avoid paying the post-filing stub portion of the rent for the petition month, claiming that since the rent for the month came due prior to the petition, the *entire* month's rent is pre-petition and, therefore, only entitled to general unsecured claim status (a lower priority in the bankruptcy distribution scheme). However, many bankruptcy courts have enforced the debtor's obligation to pay the pro rata portion irrespective of the due or billing date.

Another impact of the *Koenig* decision has been, with respect to back-end stub rent, that the debtor may fix the effective date of lease rejection as the last day of the month (so as to avoid paying a full month's rent for the ensuing month), notwithstanding the fact that the actual date of vacating or the surrender of the premises may be significantly later. If not challenged, the debtor will usually try to pay little or no rent for the month in which the surrender occurs.

Both types of stub-rent issues were faced by the rejected landlords in the *Snyder* bankruptcy case, and it is not at all surprising that the competently represented debtor would try to shave or eliminate its stub-rent obligations as much as possible,

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given that the objective in bankruptcy is to maximize the bankruptcy estate's assets for all of its creditors as well as to support its ability to fund its plan of reorganization. The debtor will calculate that many landlords will decide that there is not enough at stake to warrant even a modest legal expense in challenging the debtor's rejection proposals; and the debtor will sometimes be correct in that assessment.

However, if you as the landlord do have enough at stake, the most advisable approach is to be vigilant, and to engage competent counsel at an early stage, possibly the same counsel that is representing one or more similarly situated landlords—thus building a perceived constituency and sharing the cost burden. Quite possibly, such counsel will not only object to a rejection motion that seeks an order evading the post-petition rental obligations, but will also file a motion to compel the immediate payment of post-petition rental obligations—thus bringing the issue to a head at the earliest possible time.

This is one situation in which the squeaky wheel probably gets the most oil!

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Closing the Loop on Radius Restrictions

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A retail landlord will always seek to insert a radius restriction clause into each lease at its shopping center. A radius restriction is a covenant prohibiting a retail tenant from owning, operating or having a financial interest in a competing store within a certain specified radius of the center. This restriction is generally included where the tenant's rent is based, at least in part, on a percentage of sales generated by the store; if a tenant opens another store near the center, it could detrimentally impact sales at the center's store and thus reduce the percentage rent paid to the landlord. Another reason why a landlord may include a radius restriction is to prevent another of the tenant's stores from decreasing the number of visitors to the center, as such a decrease could also result in less income to the landlord from other tenants with percentage rent clauses in their leases based on lower sales at other stores in the center.

A tenant will generally resist a radius restriction, believing that it is better able to determine what the market will bear regarding the proximity of its retail outlets to one another, and because it would be adverse to the tenant's economic interest to have stores located so close to one another that either (or both) of them underperforms. While valid, these arguments do not always sway landlords, as it is not unusual for tenants to open stores closer than what would be the optimal distance in an effort to "protect" them from encroachment by their competitors. Although this may decrease sales at the store at the center, it may make sense to a tenant as part of its overall business strategy to maximize sales in a geographic area.

This article provides a guide to state and federal law regarding radius restrictions in shopping center leases. Discussed here are what constitutes a reasonable radius; how to determine what are "reasonable" remedies available to a landlord, should a tenant breach a radius restriction; and general factors a landlord should consider when drafting a radius clause.

General

To be valid and enforceable, a radius restriction clause in a shopping center lease must be reasonable in scope, duration and territory, and should promote a valid business purpose [Halpern, "Negotiating Radius Clauses," *Shopping Center World* (Jan. 1996)]. Although a general rule of reason analysis applies to disputes heard in federal court, it is important to also check applicable state law because anti-trust and restraint of trade laws vary from state to state. Although most state courts uphold radius restriction clauses [*see, e.g., Winrock Enterprises, Inc.* v. *House of Fabrics of New Mexico*, 91 N.M. 661, 663 (1978), where the court held that "[r]adius restrictions serve a legitimate business purpose" and found that a 2-mile restrictive radius was not an unreasonable restraint of trade], a radius clause violates the Michigan statute, regardless of its reasonableness [*Saginaw Joint Venture* v. *Elias Bros. Restaurant, Inc.*, 106 Mich. App. 274 (1981)].

Typically, a radius restriction clause in a shopping center lease that prohibits a tenant from operating a competing store within a 3-to-5-mile radius of the tenant's outlet at the center will be upheld as reasonable by the courts; however, in urban areas, where retail trade areas are significantly more concentrated due to much higher population densities, a significantly smaller radius restriction may be considered reasonable.

If a tenant breaches a radius restriction covenant, a landlord's remedies may include injunctive relief or a recalculation of rent to compensate the landlord for sales lost to the store opened within the restricted territory. When provided for by the lease, a landlord may also seek other appropriate damages. Because other factors may affect the enforceability of a radius restriction, such a clause should address the sale of the center, the sale of the tenant's business and the merger of the tenant with another retailer.

Distance

The reasonableness of a radius restriction over a tenant's right to operate a competing business is a function of both the tenant's type of business and the demographics of the community in which the leased property is located [Practicing Law Institute, *Real Estate Law and Practice Court Handbook Series, N4-4602,* p. 11 (1997), citing "Drafting Shopping Center Leases," *Real Property, Probate and Trust Journal,* Vol. 2, No. 2 (1967)]. In urban areas, where neighborhood shopping is common, a reasonable radius may be no greater than a few city blocks, even as little as 1,000 feet [*Friedman on Leases* (4th ed.) § 6.701 (1999)]. Conversely, a radius clause restricting the activities of a tenant in a less developed area may be found reasonable, even if it extends several miles in every direction, depending in part upon the population and the location of other shopping centers in the surrounding geographic area. Generally, however, it is rare to find radius restrictions of greater than 5 miles; restrictions of 3 miles or less are far more common [Murray, "Percentage Rent Provisions in Shopping Center Leases: A Changing World?" *Real Property, Probate and Trust Journal,* Vol. 35, No. 4, p. 741, n.10 (2001)].

In evaluating the reasonableness of a radius restriction, the lease preparer needs to consider whether the tenant's business is primarily local, or whether it is a regional destination location. Supermarkets, for example, serve a much smaller geographic

customer base than specialty shops [Halpern, *Shopping Center and Store Leases*, Rev. Ed., Vol. 1, § 9.06[3] (2003)]. Accordingly, a court might find a 3-mile radius restriction to be unreasonable for a supermarket, while a similar restriction placed upon a neighboring store in a center selling clothing under a specific brand name might be found reasonable. To avoid anti-trust concerns, a retail lease should not contain a radius that exceeds the center's trade area (Rees, "Drafting Radius Restrictions," *Shopping Center World,* March 1997).

Rule of Reason

A radius restriction in a lease, being a form of anti-competitive covenant, may violate state restraint of trade laws, the Sherman Antitrust Act and/or the Federal Trade Commission Act [Bender, *Current Leasing, Law and Techniques*, § 6.14[4], n. 19 (2004)]. In *Continental T.V., Inc.* v. *GTE Sylvania Incorporated*, 433 U.S. 36, 49 (1977), the U.S. Supreme Court reaffirmed that the rule of reason is the "standard of analysis for scrutinizing most business relations under the Sherman Act" [as cited in *Optivision, Inc.* v. *Syracuse Shopping Center Associates*, 472 F.Supp. 665, 674 (1979)]. Under the rule of reason analysis, "the fact-finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition" (*Continental T.V.,* at 49). Subsequent federal decisions established that the "focus of the analysis must be upon the impact of the challenged activity on competitive conditions in the relevant market" [*Optivision*, at 674, citing *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 687-88 (1978)].

Courts at both the federal and state levels have applied the rule of reason analysis to anti-competitive clauses of retail leases (Halpern, *Shopping Center and Store Leases,* at § 9.06[2], n. 6; Bender, *Current Leasing,* § 11.11[3] & [5]). The relevant criteria for evaluating restrictive covenants under the rule of reason are well illustrated in *Child World Inc.* v. *South Towne Centre Ltd.*, 634 F.Supp. 1121 (S.D. Ohio, 1986). The *Child World* analysis was applied to a radius clause restricting the activities of a landlord; however, the same analysis may be analogized to a radius clause restricting a tenant's activities. The factors considered by the *Child World* court were: (1) the relevant product and geographic markets, together with the showing of unreasonable impact upon competition in these markets due to the restrictive covenant; (2) the availability of alternate sites for the entity excluded by the operation of such a covenant; (3) the significance of the competition eliminated by the exclusivity (radius) clause, and whether present or future competitors were the parties excluded; (4) the scope of the restrictive covenant (the radius clause) and whether it varied depending on particular circumstances; and (5) the economic justifications for including the restrictive covenant in the lease (*Child World,* at 1130-1131).

Although reasonable radius clauses in retail leases are generally viewed as enforceable, state cases where the question has been tried are limited [*Drafting Shopping Center Leases*, at 12; Chupack, "Applying Antitrust Law to Shopping Centers" (with Checklist), *Practical Real Estate Lawyer,* Vol. 9, No. 3, p. 63 (May 1993)]. However, in *Carter* v. *Adler*, 138 Cal.App. 2d 63, 73 (1955), the court ruled that "[n]either lessee nor lessor can avoid liability for damages where they are operating under a percentage rental lease and either conducts a competing business on adjacent premises, causing a reduction of the gross receipts on the demised premises." Although the *Carter* decision addressed a competing business on an adjacent property, rather than one within a specified radius, the court's holding demonstrates California's acceptance of reasonable non-compete provisions in shopping center leases.

Notwithstanding that the Federal Trade Commission (FTC) has jurisdiction over anti-competitive practices in retail leasing, the FTC has not been very active in enforcement in this area since 1977 [*In the Matter of Sears, Roebuck & Co*., 89 F.T.C. 240 (1977); the FTC modified the order in 1989 to allow radius clauses that restrict tenants from operating a similar type of store or offering similar types of products or services within a certain radius of a shopping center (U.S. Federal Trade Commission, 1989 Annual Report)].

Remedies Available to Landlords

A landlord's remedies in the event of a tenant's breach of a radius restriction may include injunctive relief or monetary damages [*Unishops, Inc.* v. *Mays Family Center, Inc.*, 399 N.E.2d 760 (Ind. App. 1980); *Shactman* v. *Masters-Lake Success, Inc.*, 222 N.Y.S.2d 171 (Sup. Ct. 1961), *aff'd* 16 A.D.2d 679, 227 N.Y.S.2d 247 (2d Dep't 1962)]. If a court finds a radius restriction reasonable, it may prohibit the tenant from opening a second location within the restricted area. However, landlords and tenants typically address the issue directly in the lease rather than wait for the matter to wend its way through the courts. Where the tenant is obligated to pay percentage rent, damages to a landlord should equal the lost rent resulting from the decrease in sales caused by the competing store. One way this issue is often addressed is to include a provision that includes all sales, or a percentage of sales, from the competing store when calculating percentage rent (Murray, "Percentage Rent Provisions," at 10-11). However, including sales from a store opened in the restricted area, while common, may not be free of challenge in all states (Halpern, "Negotiating Radius Clauses"). Further, many states require that liquidated amounts be reasonable, not punitive (Rees, "Drafting Radius Restrictions").

An alternative is to set liquidated damages at the greater of: (a) a specified percentage of gross sales at the premises or (b) the gross sales of the tenant's store in the restricted area [Compton and Stein, "Landlord's Checklist of Silent Lease Issues," *NYSBA N.Y. Real Property Law Journal,* Vol. 30, No. 3, p.140 (2002)]. If the landlord can prove that the competing store has damaged other tenants or the overall value of the shopping center property, additional damages may be warranted (Chupack, "Applying Antitrust Law to Shopping Centers," at 67).

Other Issues to Consider When Drafting a Radius Clause

In addition to the range of the radius and damages, there are other issues that the preparer of a retail lease should consider when drafting a radius restriction, including that competition restricting covenants is generally not favored by courts unless it is expressly stated in the language of the lease (Bender, *Current Leasing,* § 3D.15[5]). As an example, the California Supreme Court has stated five prerequisites for finding implied covenants: (1) the implication must arise from the language used or it must be indispensable to effectuate the parties' intention; (2) it must appear from the language used that the parties so clearly contemplated it that they deemed it unnecessary to express it; (3) implied covenants can only be justified on the grounds of legal necessity; (4) a promise can be implied only if it can be rightfully assumed that it would have been made if attention had been called to it; and (5) if the subject matter is completely covered by the contract, there can be no implied covenant [*Lippman* v. *Sears, Roebuck & Co.*, 44 Cal. 2d 136 (1955), which involved the breach of an implied covenant to remain in business]. Therefore, the lease preparer should be very specific when drafting terms restricting a tenant's right to operate a competing store.

Measuring the Radius

A radius restriction should clearly set forth the point from which the radius is measured. If a lease is in a large shopping center with extensive parking, the landlord will want to maximize the radius by measuring from the outside perimeter of the shopping center property (Chupack, "Applying Antitrust Law to Shopping Centers," at 66). The provision should also state how the distance of the radius is measured— "as the crow flies" (a straight line disregarding geographic features) —covers a larger area than the same distance measured along street routes (Halpern, *Shopping Center and Store Leases,* § 9.06[4]). Another method is to measure along surface streets in one direction, highway routes in another [Lentzner, "The Antitrust Implications of Radius Clauses in Shopping Center Leases," *University of Detroit Journal of Urban Law,* Vol. 55, p. 4 (1977); reprinted by the Practicing Law Institute, *Real Estate Law and Practice Course Handbook Series*, N4-4571 (1993)]. Regardless of the method used, the lease must strike a balance between maximizing the landlord's protective area while not unreasonably restraining the tenant's trade.

Duration of the Restrictive Covenants

In addition, a lease should specify the period of time for which the radius restriction is in effect. Usually, such a provision will be effective for the entire term (Lentzner, "The Antitrust Implications of Radius Clauses in Shopping Center Leases," at 11). However, the lease preparer should be aware that a substantial change in the demographics of the area around the shopping center may render a prolonged radius restriction as anti-competitive and invalid under restraint of trade laws. Anti-competitive clauses that extend well beyond the term of the lease would probably be found to be a restraint of trade.

Change in Parties to the Lease

A radius restriction provision should also address the possibility that the shopping center may be sold, or that the tenant's business may be sold or merged with another retailer. Therefore, it is important to clearly state what constitutes a competing business and to establish the transferability of the restrictive provisions of the lease. The right of an assignee of the property to enforce the restrictive covenant should be specifically stated in the lease. Additionally, the lease should state that affiliates of the business operating under the lease are bound by the terms of the radius restriction, as well as purchasers of the business and any company with which the tenant may merge. However, this may be difficult when the store is a subsidiary of a larger company, in which event the tenant is probably unable to bind the parent company to the terms of the lease (Chupack, "Applying Antitrust Law to Shopping Centers," Vol. 9, No. 3, at 66-67).

Clear Definition of Restricted Activities

It is also important for the radius restriction to include a clear definition of the business, trade or trade name covered under the radius clause. A well-drafted description of a tenant's business may prevent a tenant from circumventing a radius restriction by opening a competing store under a different name or through an affiliated business entity, and usually a lease provides that a "substantially similar" line of business or trade name prohibition is included (Rees, "Drafting Radius Restrictions"). Also, the lease preparer should address whether the tenant or an affiliate of the tenant operates any existing stores within the restricted area, and whether the tenant intends for existing stores to remain open during the term. If the store is a franchise, the parties will need to consider whether the proposed radius restriction provision risks violating the tenant's franchise agreement. Additionally, some radius clauses stipulate that the tenant is not permitted to advertise, or direct sales to, another location within the restricted area (Bender, *Current Leasing*, § 3D.15[5]).

Internet and Catalog Sales

As a growing number of stores become showrooms or points of order for Internet and/or catalog sales, a radius restriction should be clear on how to measure sales generated by the subject store. One method is to include, for purposes of percentage rent, all customer orders taken, or products shipped, from the store covered under the lease [Hameetman and Ticknor, "How

e-Commerce Affects Your Lease," *Shopping Center World* (Oct. 1999)]. Another approach is to require the tenant to pay percentage rent on all sales made or shipped within the restricted area (Murray, "Percentage Rent Provisions," at 18). At present, there is no clear formula for including Internet sales under a percentage-of-sales lease, and it is likely that disputes will be resolved on a case-by-case basis. (Hameetman and Ticknor, "How e-Commerce Affects Your Leases," at 2).

Conclusion

In summary, an attorney representing a shopping center landlord needs to consider many issues when drafting a radius restriction for a tenant's lease. Distance, time and the type of businesses covered are all important factors in determining whether a radius restriction clause will be viewed by a court as overly restrictive, or as a reasonable protection of a landlord's right to either (i) collect rent under a percentage rent provision in a lease and/or (ii) increase the probability of success of its shopping center by maximizing the number of visitors. Although the leading case law and legal analysis regarding radius restriction clauses and the rule of reason were established over 25 years ago, the factors for determining whether a radius restriction provision is reasonable remain largely unchanged. Nevertheless, as development continues to encroach into formerly rural areas, drafters of radius restriction clauses need to be attentive to how evolving demographics may affect judicial interpretations of what is a reasonable radius restriction. Further, as Internet commerce grows and retail chains expand and/or consolidate, which may result in substantial growth in their shares of the market for consumer goods, landlords also need to be continually diligent in drafting lease provisions to prevent tenants from circumventing the intent of radius restriction provisions in an effort to reduce their rent.

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California Appellate Courts Rule on Enforceability of Estoppel Certificates

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The most common use of estoppel certificates in real estate transactions is for prospective mortgagees or purchasers of leased property to ascertain the interests of tenants who will remain in possession of the property under existing leasehold estates following the closing of the purchase or mortgage. Often the lease itself obligates the tenant to provide an estoppel certificate on demand. The estoppel certificate is worded to deliberately discourage the tenant from asserting claims not disclosed in the certificate, and to make accurate and complete disclosures.

Certificate Contents

The estoppel certificate in a real estate transaction generally contains the following information:

(1) An acknowledgment that the lease (usually attached as an exhibit) is a true and correct copy of the parties agreement; is in full force and effect; and has not been modified, altered or supplemented (except and to the extent otherwise set forth);
(2) The amount of the fixed (or base) rent and any supplemental, additional or percentage rent, and the base year (if applicable);
(3) A statement that there is no prepaid rent in excess of one month (except and to the extent otherwise set forth);
(4) The amount of the security deposit;
(5) The commencement and termination dates of the lease;
(6) Any significant rights held by the tenant, such an option to extend; an early termination right; or an option (or right of first refusal) to purchase the property;
(7) An acknowledgment that the lease is free from default by landlord or tenant, and that the tenant has no claims for off-set or deductions or any other defenses against the landlord under the lease (except and to the extent otherwise set forth);
(8) A statement that all work required to be performed by the landlord under the lease has been completed and is acceptable;
(9) A statement that there is no free rent and that there are no credits, allowances or abatements (except and to the extent otherwise set forth);
(10) A representation that the tenant has not assigned, sold, pledged, subleased or otherwise transferred all or any portion of its leasehold interest (except and to the extent otherwise set forth);
(11) A representation that no insolvency or bankruptcy proceedings are pending or threatened against the tenant; and
(12) An acknowledgment that the statements contained in the estoppel certificate will be relied upon by, and are for the benefit of, the lender (or other third party for whose benefit the estoppel certificate is provided), its successors and assigns.

Poor Drafting Can Lead to Problems

Estoppel certificates executed by tenants in connection with sales of commercial property, if not accurately and fully completed, can have severe and unintended legal consequences. These consequences are amply illustrated by two recent California appellate court decisions.

The Plaza Freeway Case

In *Plaza Freeway Ltd. Partnership* v. *First Mountain Bank,* 81 Cal.App. 4th 616 (2000), the California appellate court held that an estoppel certificate the tenant executed in connection with the landlord's purchase of the property constituted a written "instrument" within the conclusive presumption created by the California Evidence Code. Section 622 of the California Evidence Code provides that facts recited in a written instrument are true as between the parties or their successors. Based on this statute, the court determined that the tenant was estopped in unlawful detainer proceedings from contradicting the lease termination date set forth in the certificate, even though the termination date was inaccurate and the exact termination date intended under the lease was unknown.

This issue arose in connection with the tenant's attempt to exercise an option to extend the term of a commercial property lease, which covered the premises in a shopping center in Big Bear, Calif. The lease required the tenant to notify the landlord in writing of its intent to renew 12 months before the expiration of the lease term. The landlord, however, claimed that, based

on the lease expiration date set forth in the tenant estoppel certificate executed by the tenant (which had been signed, after review, by the tenant's chief financial officer), the notice from the tenant was too late and, therefore, ineffective to extend the lease term. The tenant argued that because the parties had never executed a contemplated addendum to the lease setting forth the actual commencement date, and because the tenant opened for business on a date more than six months after the commencement date stated in the estoppel certificate, equity dictated that the notice be deemed appropriate. The trial court agreed with the tenant, but the California appellate court reversed and held for the landlord.

The appellate court first noted that under § 622 of the California Evidence Code, "[t]he facts recited in a written instrument are conclusively presumed to be true as between the parties thereto, or their successors in interest. . . ." The court, after reviewing the applicable case law (as well as Webster's Dictionary definition of "instrument"), held that although "instrument" usually refers to a contract, the estoppel certificate nonetheless constituted a written instrument under this provision of the California Evidence Code because "[t]he written paper or instrument need not represent an agreement" (citation omitted). *Id.*, at 622.

The court noted the significant reliance that commercial sellers, purchasers and lenders place on the reliability of a tenant estoppel certificate in a commercial real estate transaction. The court found that a tenant estoppel agreement "reveals the present intent and understanding of the parties to a commercial lease agreement," and "is exactly the type of document to which application of § 622 would be appropriate." *Id.*, at 626.

The court also noted that the introductory paragraph of the estoppel certificate stated that the purchaser and the lender were relying upon the representations made therein in connection with the purchase of the property and the funding of the loan. The court, therefore, ruled that even if the estoppel certificate contained an erroneous statement as to the lease terms, the recitations contained therein would be conclusively presumed to be true under § 622. As the court noted in support of its ruling, "application of section 622 to estoppel certificates would promote certainty and reliability in commercial transactions. A contrary conclusion would defeat the purpose behind the widespread practice of using estoppel certificates." *Id.*, at 629.

The Miner Case

In a subsequent case, decided by a different division of the California appellate court, *Miner v. Tustin Ave. Investors,* 116 Cal.App. 4th 264 (2004), the commercial lease entered into between the parties contained an option to extend the lease for five years, to be exercised by the tenant no later than June 2002. In November 2001, the tenant signed an estoppel certificate, at the request of the purchaser of the property from the original landlord, stating that the lease was in full force and effect. The estoppel certificate contained language that the tenant had no options "except as follows," but the tenant left the lines that followed this language blank and made no mention of the option to renew. In May 2002, six months after signing the estoppel certificate, the tenant informed the purchaser of the property (as successor landlord) of its intention to exercise its option to renew the lease. The parties were unable to agree on the rental rate for the renewal, and the tenant brought a declaratory judgment action for a determination of the renewal rental rate, and claimed that he had validly exercised his option rights. The successor landlord asserted that the estoppel certificate, which made no mention of the tenant's renewal right, eliminated the tenant's option contained in the lease.

The successor landlord relied solely on the *Plaza Freeway* case and the section of the California Evidence Code cited therein. The tenant countered that the estoppel certificate was ambiguous, and that the language in the certificate regarding options applied only to "other options and first rights of refusal" that were not already part of the lease itself. The trial court determined that the *Plaza Freeway* case was controlling and ruled in favor of the successor landlord, but suggested that the case be appealed because of the importance of the issue.

The appellate court reversed the holding of the trial court, first finding that there was an ambiguity in the documents entered into by the parties. According to the appellate court, the estoppel certificate referenced the lease as being "in full force and effect," and the question as to whether the option to renew continued to exist could be determined only by reading the lease and the estoppel certificate together. The court reasoned that because no extrinsic evidence had been introduced as to the parties' intent, and because an ambiguity should be resolved "against the party who caused the ambiguity to exist," an interpretation favoring the tenant's position should be adopted. The court held that because "there is no exception in . . . the Estoppel Certificate for the option provision . . . we decline to judicially insert one." *Id.*, at 272.

The appellate court distinguished the *Plaza Freeway* case on the basis that in *Plaza Freeway* there was no written document that ever specified the actual commencement date, whereas in *Miner*, the exact opposite situation existed: the option term was clearly stated in the lease but not clearly stated in the estoppel certificate. According to the court, "Plaza Freeway correctly states the governing principles, but application of these principles results in reversal here." *Id*. In a somewhat strained interpretation of the language in the estoppel certificate regarding option rights in the *Miner* case, the court found that it was "plausible" that it was designed "to identify option provisions that are separate and independent from those contained in the Lease" (such as cutting off option claims other than those expressly set forth in the lease, or notifying the landlord of option rights not contained in the lease). *Id*. The court also determined that the tenant had not specifically waived his option rights, and "[t]here is no justification for adding an express waiver into the landlord-supplied Estoppel Certificate when the landlord itself did not choose to do so." *Id*. The court also stated that its ruling was consistent with "basic principles of commercial real estate law," which the court found encouraged the enforceability of contractual options permitting tenants to remain

in the leased premises beyond the original lease term. *Id.*, at 273. Upon remanding the case to the trial court, the appellate court did, however, acknowledge the importance of estoppel certificates in commercial real estate transactions and stated: "[o]ur decision leaves all issues open for trial, including the meaning of the Estoppel Certificate, should there be any competent extrinsic evidence on the subject, as well as the viability of [the tenant's] attempts to exercise his option." *Id.*

It is apparent that the holding in the *Miner* case was driven by equitable considerations and by the desire of the court to "do the right thing." The court strained, based on the facts in the case, to distinguish the earlier *Plaza Freeway* decision by the California appellate court. It seems clear that the court in the *Miner* case was bothered by the fact that the tenant had timely (under the lease) notified the successor landlord of its interest in extending the lease, and that the successor landlord claimed that the option was void (because of the lack of any reference in the estoppel certificate to the renewal right) only after the parties had engaged in lengthy negotiations and were unable to agree on the rental rate for the option term. On remand to the trial court, the court did leave open the possibility of admitting any relevant "extrinsic evidence" bearing on the actual intention of the parties regarding the option right. As the court noted, a provision in the lease specifically required the tenant to provide an estoppel certificate upon 10 days' prior notice or it would be in material default, and further provided that "[a]ny such statement may be conclusively relied upon by any prospective purchaser or encumbrancer of the Office Building Project or of the business of Lessee."

Conclusion

The holdings in the foregoing California cases should serve as a cautionary tale for parties to a commercial real estate transaction who may be tempted to minimize the significance of tenant estoppel certificates and the information contained therein and their legal consequences. The vast majority of decisions, however, support the holding of the California appellate court in *Plaza Freeway, supra,* and uphold the strict enforcement of estoppel certificates based on factors such as public policy concerns, the need for certainty in real estate transactions, reliance by third parties, and the sophistication and bargaining strength of the parties in commercial real estate transactions.

For example:

- In another (unreported) California appellate decision (decided subsequent to *Plaza Freeway, supra,* but prior to *Miner, supra)*, *Campagna* v. *Gatley Properties*, 2003 Cal. App. Unpub. LEXIS 1218 (Feb. 3, 2003), at *16, the court stated: "Tenants' estoppel certificates are used in commercial real estate transactions to protect the buyer who is purchasing real property subject to leases (citing *Plaza Freeway Ltd., supra*). An estoppel certificate in which the tenant confirms the basic terms of the lease, including rent, estops the tenant from claiming otherwise after the sale is closed (citing *Plaza Freeway Ltd., supra*). . . [a]n estoppel certificate binds the signatory (citing *Plaza Freeway, supra*, and Cal. Evid. Code, § 622)." See also *General Electric Capital Corp.* v. *Domino's Pizza*, 1994 U.S. Dist. LEXIS 7277 (D. N.Y. 1994), at *12-14. (Under clear language and intent of a valid estoppel certificate signed by the tenant to induce the lender to loan money to the landlord, the tenant was obligated to obtain written consent before it could terminate the lease.)
- *Freshman* v. *Attaboy Mfrs. Representative, Inc., supra*, 1993 Ohio App. LEXIS 630, at *11-12. (An estoppel certificate executed by the tenant explicitly protected the landlord against any claim of prepaid rent by the tenant, and was enforceable.)
- *Net Lease Holding Trust* v. *Maggart*, 1995 Tenn. App. LEXIS 705 (Tenn. Ct. App. 1995), at *7-8. (A landlord was not estopped from collecting rent from tenants who had prematurely surrendered property based on a representation concerning expiration of the lease, because they could have determined the expiration date by consulting the lease or estoppel certificate executed by the tenants; the tenants were on "equal terms" with the landlord.)
- *SRM Card Shop, Inc.* v. *1740 Broadway Assocs.*, L.P., 2 A.D.3d 136 (N.Y. App. Div. 2003), at *8-10. (A commercial tenant was not entitled to rent reduction where its claim for such reduction was expressly contradicted by an estoppel document executed by its corporate parent.)
- *Virginia Highland Associates* v. *Allen*, 174 Ga. App. 706, 709-10 (Ga. Ct. App. 1985). (Public policy, good faith, equity and justice required that an unqualified tenant estoppel certificate executed by the tenants stopped them from raising a novation defense.)
- *Yee* v. *Weiss*, 110 Nev. 657, 662 (Nev. 1994). (Even though he did not read it, a commercial tenant was bound by an estoppel certificate he signed at the request of new landlords, which stated that the conditions of lease to be performed by the landlord had been satisfied.)
- *Cf. N. Houston Int'l, LLC* v. *PW Real Estate Invs., Inc.*, 2003 Tex. App. LEXIS 9185 (Tex. App. LEXIS 9185) (Tex. App. 2003). (A commercial lender was granted summary judgment, where the prospective borrower failed to perform a condition precedent of providing an estoppel certificate from the anchor tenant, where it should have known that it could not perform, that it had control over its performance and that conditions had not changed since execution of the loan commitment letter.)

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To avoid resorting to litigation and having a court decide what the parties actually intended, an estoppel certificate should be treated as an important legal document and be carefully analyzed and reviewed before execution, to ascertain the completeness and accuracy of the recitations and representations set forth therein. The lease and the estoppel certificate should be compared to make certain that they are consistent with each other and do not contain any ambiguities or conflict-

ing statements or provisions (unless fully explained and disclosed in the estoppel certificate). As evidenced by the California cases discussed above, court decisions in this area—which are infrequent—are often fact-based and unpredictable.

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Coughing on a Dusty REA: *Saul* v. *Home Depot*

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Often, in an effort to maximize the profitability of land, several property owners agree to a joint development plan. Ideally, such joint plans allow for complementary uses, thereby benefiting all of the parties involved. But what happens when these plans are no longer in the best interest of one of the property owners? Is the original expressed intent of the parties binding even when the plans are dated and no longer allow for one of the property owners to maximize the profitability of its land? Such a Reciprocal Easement Agreement ("REA") was the focus in *Saul* v. *Home Depot*, 2004 Ky. App. LEXIS 223 (July 30, 2004), where Kentucky courts had to distinguish between mere expressions of intent and language that were actually binding on the parties.

In 1969, two adjacent property owners came to a seemingly innocent REA to develop their properties jointly as an indoor mall with shared access and parking, and with some building and use restrictions. The REA explained that the two properties were to be developed as "one (1) mall-type shopping center" with a common parking area. In 1997, a subsequent owner of one of the properties sold its parcel to Home Depot ("Home Depot's tract"), which planned to raze most of the department store building on its tract in order to obtain government approvals for, and to build, a large freestanding "big-box" store in what was then part of the mall's primary parking lot. While the number of parking spaces provided by the new plan would comply with the local parking codes, the parking and traffic patterns of the mall would be changed significantly. At the time of the acquisition by Home Depot, the mall, although in need of updating, was nearly fully occupied and producing substantial income. Despite this fact, Home Depot believed that the connected mall structure would not serve as the most profitable use of the tract.

With knowledge of Home Depot's plan for the property, Saul, the subsequent owner of the adjacent lot containing the enclosed mall and another department store ("Saul's tract"), dusted off the REA in an attempt to thwart Home Depot's changes. Prior to Home Depot consummating the purchase of the property, Saul, relying on the REA, initiated litigation seeking a permanent injunction against Home Depot's stated purpose, which was denied. Home Depot, following the denial of the injunction and approval of its plan by the local planning commission, cast any worries of the REA aside and quickly began razing the connected department store building and constructing the unconnected big box with a typical garden center and outside sales area.

Three months after starting its redevelopment efforts, Home Depot was in the Fayette Circuit Court, defending itself against Saul for an alleged violation of the REA. The trial court interpreted the restrictions of the REA as applying only to the owner of Saul's tract and not to the Home Depot tract. The court based its holding on the following language within the REA:

> The property described in Exhibit "A" [(Saul's tract)] hereto, and not described in Exhibit "B" [(Home Depot's tract)] hereto, is restricted so that the owner thereof may construct thereon no building without the written consent of the owner of the property described in Exhibit "B" ….

According to the circuit court, this language required the owner of Saul's tract to acquire written consent from the owner of Home Depot's tract to construct a building. Because Home Depot's tract was not expressly subject to a similar restriction, the court held that Home Depot had acted prudently in proceeding with its construction plans. In reaching the decision, the court gave no weight to the planning commission's approval, stating that the commission's decision was based on land use regulations and did not consider the REA. Throughout the trial and the appeal by Saul, Home Depot steamed ahead with its construction.

On appeal, the Court of Appeals of Kentucky focused on two issues: (1) the proper interpretation of the REA and (2) the impact of the REA on the planning commission's approval. As to the REA, the court looked at the entire agreement and the attendant circumstances in reversing the circuit court. The court of appeals stated:

> Although the owner of Exhibit B [(Home Depot's tract)] may not need permission to build subsequent buildings, we believe the restrictions that apply to both parties would require that the main structure be attached to the mall and that the designated parking "shall be used …" and shall remain essentially the same.

Following this interpretation of the REA, the court held that Home Depot's construction of a freestanding building in the parking lot violated the REA, by not only because it was a second structure, but also because it reduced the number of parking spaces.

As to the approval of Home Depot's plans by the planning commission without Saul signing off, the court of appeals affirmed the circuit court on this issue, stating that "the planning commission deals with public land use controls, and their

actions have no effect on private restrictions." Again, the private agreement did not bear on the decision of the planning commission, and the planning commission's decision did not bear on the private agreement.

The court of appeals, following its decision, remanded the case to the circuit court for a determination of the proper remedy for Home Depot's violation of the REA. When the court of appeals handed down its opinion, the construction on the new Home Depot store had been completed. Following the reversal, Home Depot filed a motion to reconsider, which was denied. In a last-ditch effort, Home Depot filed for discretionary review with the Kentucky Supreme Court, which was also denied.

On remand, the parties, facilitated by the circuit court judge, invested considerable time in attempting to reach a settlement. Although at one point the parties had actually agreed to a settlement, the terms of that agreement were not written before the parties broke for the day. By the time the parties put the agreement on paper, they disagreed as to what they had agreed upon. The major sticking points in the talks were the details of what use and construction restrictions would be in a replacement REA—these points being very significant to each of the parties. Left with few options, the circuit court, guided by the court of appeals decision, held on summary judgment that "Home Depot must undo that which should not have been done by removing the violative building and restoring the appropriate mall structure."

In Home Depot's Memorandum in Opposition to Saul's Motion for Partial Summary Judgment, Home Depot labeled Saul's insistence on injunctive relief that would have the "Home Depot store in Lexington Mall … torn down and … the old, run-down, empty Country Market store … rebuilt" as several things including: "commercial extortion," "inequitable," "illogical," "wasteful," "unjust" and "absurd." In adopting much of Saul's Memorandum in Support of Motion for Partial Summary Judgment in its opinion, the circuit court stated that: "Given that Home Depot acted with knowledge and that Saul's rights are established [by the court of appeals], this Court cannot take into consideration such inconvenience and injury as may occur to Home Depot from imposing injunctive relief." Ultimately, Home Depot made its bed and now must lie in it.

In reaching its holding, the circuit court delved into Kentucky's case law regarding relief for violations of restrictive covenants, quoting the following language:

> If there is a negative covenant (restrictions) . . . [sic] the court has no discretion to exercise. If parties for valuable consideration, with their eyes open, contract that a particular thing shall not be done (or their successors), all that a court of equity has to do is say, by way of injunction, that the thing shall not be done. In such a case, the injunction does nothing more than give a sanction of the process of the court to that which already is the contract between the parties. It is not, then, a question of the balance of convenience or inconvenience or of the amount of damage or injury: it is the specific performance by the Court of that negative bargain which the parties made, with their eyes open, between themselves.

The court went further to say that: "When a property owner 'deliberately and intentionally violates a valid express restriction running with the land or intentionally "takes a chance," the appropriate remedy is a mandatory injunction to eradicate the violation.'"

Following the circuit court's holding, Home Depot filed another appeal to the court of appeals where the judgment was affirmed on July, 30, 2004. Home Depot, not satisfied with the affirmation, filed a motion to reconsider with the court of appeals, which was denied. Following the denial of the motion to reconsider, Home Depot again filed a petition for discretionary appeal with the Kentucky Supreme Court, which, at the time of publication, was pending. To date, the Home Depot store at the Lexington Mall remains in operation, despite Saul's efforts to enforce the REA.

With the conflict still raging between the parties, the eight-year court battle can be viewed, if nothing else, as a lesson in litigation tactics leading to functional results. Throughout the proceedings, Saul has accused Home Depot of rushing construction and delaying hearings in an attempt to have an operational store before the courts would hear the case. The logic behind Home Depot's actions, in Saul's opinion, being that a court would be hard-pressed to tear down an operational business, considering its value to employees, the tax base and the perceived waste of such an act. In fact, Home Depot's actions seemingly put it in a poor position to bargain with Saul, considering that the law was on Saul's side in the matter. As of now, with the Home Depot store remaining in operation, Home Depot's tactics, despite the court of appeals holding it in violation of the REA, have done little to slow down its retail business at the Lexington Mall.

Ideally, the lesson learned here is that no matter the age of the agreement or its current utility, parties must understand the restrictions that are in place and abide by the dictates of such agreements. If the parties choose not to, they do so at their own peril. In drafting REAs, CCRs and other long-term agreements, one must do so with a look to the future, expressly reserving for the owner of the servient estate the power to relocate or provide substitute easements; otherwise, one may be handcuffed by an outdated plan or a less profitable use. Depending upon one's penchant for litigation, it may also be prudent to include a "prevailing party recovers legal fees" clause. Ultimately, the real lesson may be one of litigation tactics.

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‘Good Faith and Fair Dealing’ in Optionland

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If a tenant unambiguously tries to exercise an option but doesn’t get it right because of an obvious misinterpretation of the words of the lease, does the landlord need to say anything? Or can the landlord sit back, wait for the exercise deadline to lapse, and then laugh at the tenant (and the tenant’s counsel) for having gotten it wrong?

A January 2005 New Jersey Supreme Court case, *Brunswick Hills Racquet Club, Inc.* v. *Route 18 Shopping Center Associates*, 2005 N.J. Lexis 7, concluded that the landlord has an obligation to tell the tenant about its mistake, and give the tenant a chance to try again and exercise the option correctly. The court reached that result by applying the “implied covenant of good faith and fair dealing.” However, the court did so against a backdrop of a particularly egregious and unfortunate set of facts—a peculiar history so unusual and distasteful that the decision may end up being limited to its own facts.

Brunswick Hills Racquet Club may ultimately have little practical impact on future litigation about defectively exercised options. Nevertheless, the case certainly does give the hordes of unfortunate tenants that bring such litigation another line of authority that they can, and undoubtedly will, cite. In any event, the case teaches tenants and landlords, and their counsel, some important lessons about how to draft and exercise options in leases.

In *Brunswick Hills Racquet Club*, a tenant leased part of a shopping center, with a fixed-price option to extend the lease or purchase the leased premises by giving notice by a certain date. The lease required the tenant to include a check for $150,000 with the notice. The option price turned out to represent a great deal for the tenant and a correspondingly disastrous deal for the landlord.

The tenant without doubt tried to exercise the option 19 months before the deadline—but forgot to include a check. For the next 19 months, the tenant’s counsel tried to set up the details and final documents for the closing pursuant to the option. The landlord’s counsel took its time in answering the tenant’s counsel’s letters. Any letter to the landlord would be forwarded to the landlord’s counsel for review, which would take a few more weeks, and any letter to the landlord’s counsel would fall into an abyss while the landlord reviewed it. The parties’ counsel exchanged letters, and occasionally discussed the format for closing documentation. The landlord managed to have the tenant chase its tail for 19 months, never once suggesting to the tenant or its counsel any defect in the notice of exercise.

The option exercise deadline finally came and went. Soon after that, the landlord’s attorney “dropped the hammer,” by saying that the tenant had never validly exercised the option, because the notice of exercise did not include a check for $150,000. The landlord was right. The lease unambiguously required the tenant’s exercise notice to include a check for $150,000, but the landlord had never said a word about the omission during the 19 months between the date the tenant tried to exercise the option and the date the option expired.

Two lower courts ruled for the landlord, concluding that the tenant bore the burden of exercising the option correctly and that the landlord had no obligation to help out. The New Jersey Supreme Court reversed. The Supreme Court decision began by recognizing that commercial real estate transactions are “highly competitive,” taking place in a world where “sophisticated business entities operate according to the impersonal laws of the marketplace in which self-interest, not altruism, is the dominating principle.” *Brunswick Hills Racquet Club*, at *10. Parties need to take care of themselves. The New Jersey Supreme Court expressed the general principles of contract enforcement and interpretation as follows:

> [The tenant] did not abide by the strict terms governing the exercise of the option and, ordinarily, would suffer the consequences of its default. Courts generally should not tinker with a finely drawn and precise contract entered into by experienced business people that regulates their financial affairs. Equitable relief is not available merely because enforcement of the contract causes hardship to one of the parties. *Brunswick Hills Racquet Club*, at *27.

The court then proceeded to do exactly what it said that courts do not do. The court reviewed the particular facts of this case, and concluded that the landlord’s silence amounted to a breach of the landlord’s obligation of “good faith and fair dealing” under general contract law. The court decided that the landlord did have an obligation to tell the tenant about its mistake, and hence the court allowed the tenant to rectify the mistake even after the option period had expired.

The court recognized that “good faith” amounts to a “concept that defies precise definition.” *Brunswick Hills Racquet Club*, at *28. Passing up an opportunity to refer to Justice Brennan’s definition of pornography, the court stated: “We cannot catalogue the myriad forms of conduct that may constitute a violation of the covenant of good faith and fair dealing. Each case is fact-sensitive.” *Id.*, at *30. The court noted that any claim of breach requires a showing of a “bad motive or intention,” *Id.*, at *29. The court found it by concluding that the landlord lulled the tenant into complacency, leading the tenant to “rel[y] on the presumed good faith of [the landlord] to [the tenant’s] detriment.” *Id.*, at *33. (Of course, this construction assumes its conclusion, by accepting the notion that good faith required the landlord to tell the tenant about its mistake.)

The court concluded that the landlord had engaged in a 19-month “pattern of evasion,” in which the landlord “sidestepp[ed] every request by [the tenant] to discuss the option and ignoring [the tenant’s] repeated written and verbal

entreaties to move forward on closing . . . .” Given the tenant’s persistent efforts to move forward with closing the deal, the court said that the landlord bore some obligation to notify the tenant of the mistake it had made in exercising the option.

The court paid lip service to the notion that sophisticated parties to commercial transactions must look out for themselves, but then stated:

> [A]s our good faith and fair dealing jurisprudence reveals, there are ethical norms that apply even to the harsh and sometimes cutthroat world of commercial transactions. Gamesmanship can be taken too far, as in this case. We do not expect a landlord or even an attorney to act as his brother’s keeper in a commercial transaction. We do expect, however, that they will act in good faith and deal fairly with an opposing party. [The tenant’s] repeated letters and telephone calls to [the landlord] concerning the exercise of the option and the closing . . . obligated [the landlord] to respond, and to respond truthfully.
>
> In concluding that [the landlord] violated the covenant [of good faith and fair dealing], we do not establish a new duty for commercial landlords to act as calendar clerks for their tenants. We do not propose that attorneys must keep watch over and protect their adversaries from the mishaps and missteps that occur routinely in the practice of law. . . . [The landlord] acted in total disregard of the harm caused to [the tenant], unjustly enriching itself with a windfall increase in rent at [the tenant’s] expense. In the circumstances of this case, [the landlord’s] conduct amount to a clear breach of the implied covenant of good faith and fair dealing. *Id.*, at 39–40.

(The court labels the potential benefit to the landlord as a “windfall.” If, however, the tenant fails to satisfy the option procedures but still gets the benefit of what later turns out to be a bargain price, this apparently does not constitute a “windfall” for the tenant.)

The court emphasized the egregious nature of the facts of this case. It quoted cases warning against the wide-open and potentially unlimited scope of a judge-made covenant of good faith and fair dealing and proclaimed that it did not intend to create “potential pitfalls” that undercut the reliability of any words in any contract. *Id., at* 40. The court simply concluded that this landlord’s actions in the context of this set of facts violated the covenant. (The court could have reached the same result much more narrowly. The court could have said that when the landlord and its counsel gave the tenant the impression that they were working toward a closing —albeit very slowly—the landlord had through its conduct implicitly accepted the tenant’s exercise of the option, and waived strict compliance with its terms. That would have been enough to decide the case.)

Can the *Brunswick Hills Racquet Club* case and its broad reading of the “implied covenant of good faith and fair dealing” be limited to its own particular facts? Perhaps. And perhaps not. One can now assume that every time a tenant incorrectly exercises an option (and it seems to happen a lot!), the tenant will argue that the “implied covenant of good faith and fair dealing” requires the landlord to cut the tenant some slack. Every such tenant will try to argue that the landlord bears some implied obligation to help the tenant realize the error of its ways, and give the tenant a second chance to do a better job of exercising the option. The burgeoning jurisprudence on defective exercises of options will burgeon some more.

One might also argue that tenants are categorically less sophisticated than landlords, and typically less able to afford the proper legal work necessary to assure that tenants exercise options correctly. These theories would say that courts should cut tenants some slack and not apply the words of leases in a literal and mechanical way that deprives tenants of benefits that they reasonably expected. Tenants and their counsel should not, this argument goes, be expected to live up to every technical detail. Close enough should be good enough. This may, in fact, represent the trend of the law. It may prevent unpleasant surprises for tenants, but at the cost of creating a tremendous incentive to litigate every mistake in exercising an option (at a cost far exceeding the attorney fees saved earlier in lease administration).

Of course, even if the courts decide to welcome and encourage such litigation, every tenant and its counsel should do what they can to avoid it, both in negotiating leases and in exercising options when the time to do so arrives.

When negotiating a lease, a tenant can sometimes persuade the landlord to agree to give the tenant a reminder notice before any option expires. Perhaps the notice should even remind the tenant of exactly what the tenant needs to do to exercise the option (e.g., include a check). Of course, the same tenants who will forget to exercise their options properly are also the same tenants who lack the negotiating strength to require the landlord to give a “reminder notice.”

Along similar lines (and subject to the same practical limitation), a tenant might insist that if the tenant ever tries to exercise an option, the landlord must acknowledge receipt of the exercise notice, acknowledge that it is valid and notify the tenant within some short time if the landlord believes the notice is in any way invalid (much like the notice that a letter of credit issuer must give if the issuer intends to deny payment).

Tenants and their counsel might also reconsider whether options are worth the risks. They might, for example, negotiate a longer lease term with an option to terminate, although such an option raises all the same issues about the technicalities of proper exercise.

Once a tenant obtains an option, the tenant should make a record of it and remember to think about it long before the option exercise deadline. Counsel can play an important role here by making appropriate entries in a “tickler” file, so that counsel will remember to notify the tenant six months or a year in advance. Counsel will, however, typically want to avoid incurring an affirmative obligation to remember the option.

Tenant's counsel may also want to prepare a separate memo summarizing the terms and timing of the option and the procedure to exercise it. The best time to prepare such a memorandum would be shortly after the parties sign their lease, while memories are fresh. And the parties and their counsel should keep the memo with the lease, to increase the chance of finding it when the time comes.

Once a tenant decides to exercise an option, it should make sure to do it correctly. Here are a few points that any tenant should consider:

- Exercise the option well before the deadline, to leave time to do it again if the first time didn't work correctly.
- Read the lease. Don't assume that it says what you expect it to say.
- Comply with the specific notice procedures, requirements and addresses in the lease. If you know they're outdated (but haven't been officially replaced), comply with them anyway, and also send the notice to any other known address for the landlord.
- After exercising, request an estoppel certificate to confirm the exercise (if the lease requires broad estoppel certificates), or rely on a "further assurances" clause to request a confirmation that the option was exercised.
- Don't assume that the tenant's lawyer can exercise the option on the tenant's behalf. Exactly such an exercise occurred in *Brunswick Hills Racquet Club*, and no one made an issue of it. Some cases suggest that an attorney has no power to give any notices for his or her client. *See, e.g.*, *Siegel* v. *Kentucky Fried Chicken*, 501 N.Y.S.2d 317, 318 (1986) where the tenant "was entitled to ignore" notices from the landlord's attorney "as not in compliance with the lease provisions concerning notice," which required notice from the "landlord." Although this rule may amount to an exercise in "hypertechnicalism," would the notice from the attorney bind his or her client if the client decided after the fact that the client didn't really want to have given the notice? If the attorney's notice can't bind the client, why should it bind the other side?
- If the landlord seems to act evasively or dilatorily in implementing the exercise of the option, consider starting litigation earlier rather than later, to flush out whatever theories and claims the landlord might have about the exercise of the option. (Ideally, leave plenty of time to litigate before the option exercise deadline.)

Some of the preceding suggestions may be more realistic than others. However, they all teach a single important lesson: Tenants and their counsel should bring to options and their exercise a level of care, concern—and perhaps obsessiveness—even paranoia—that some other areas of leasing do not require. Tenants and their counsel should remember that options are almost by their nature guaranteed to be contentious.

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Eminent Domain for Economic Development: *Take* It or Leave It

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The language of the Fifth Amendment's Just Compensation Clause bestows two competing rights: it entitles the state "to take private property for public use," while simultaneously protecting the individual against state condemnation for reasons other than "public use." *See* U.S. Const., amend. V ("nor shall private property be taken for public use, without just compensation").[1] The struggle between these two rights finds its legal expression in the battle to define the scope of the term "public use." Advocates of the government's right to use eminent domain widely champion a broad definition of "public use," arguing that the protection and advancement of the health and welfare of the individual and the community, broadly understood to include such things as economic and environmental concerns, as well as an individual's direct, personal safety, health and welfare, depend on the government's ability either to condemn or strictly regulate the use of property when necessary. Conversely, contemporary advocates of "property rights" argue that the term "public use" should be narrowly construed to guard against government use of this power to benefit private financial interests and other excessive uses of this police power.

For more than 50 years, state and federal courts have leaned in favor of a broad interpretation, taking their cue from the Supreme Court's repeated admonitions that judiciaries must defer to legislative determinations of "public use." *See*, *e.g*., *Berman* v. *Parker*, 348 U.S. 26, 32 (1954). In the fall of 2004, the Supreme Court threw this history into question by granting *certiorari*, for the first time in 20 years, in an eminent domain case questioning the scope of the "public use" category. In *Kelo* v. *New London*, nine residents of the economically distressed city of New London, Conn., challenged the state's condemnation of their homes for the purpose of an economic redevelopment effort involving private developers. The Court heard oral arguments in *Kelo*, which has become one of the most widely followed cases of last term, on February 22, 2005, and is due to issue an opinion in June. The outcome of this case may seriously impact the private development industry, state and local governments' efforts at economic redevelopment, and partnerships between private and public entities.

In the 1954 seminal case of *Berman* v. *Parker*, the Supreme Court granted a major victory to the urban renewal movement by upholding the District of Columbia's Redevelopment Act of 1945. 348 U.S., at 36. This act declared that it was within the scope of the Fifth Amendment's "public use" requirement to condemn "substandard housing and blighted areas" and to transfer such property to private entities as part of a plan for comprehensive redevelopment of the city. *Id.*, at 29. The Supreme Court announced unequivocally in *Berman* that it is within the legislature's power, and not that of the Court, to define the content of the broad term "public use" and that it does not violate the "public use" requirement to employ "private enterprise for redevelopment." *Id.*, at 33. The Court reaffirmed its broad interpretation of "public use" in *Hawaii Housing Authority* v. *Midkiff*, 467 U.S. 229 (1984).

The challenged act in *Midkiff*, designed to dismantle the land oligopoly that was a vestige of Hawaii's monarchial past, authorized the Hawaii Housing Authority to use its eminent domain power to take the real property titles of private lessors and transfer them to private lessees. Upholding this exercise of eminent domain as a valid "public use," the Court explained that a court may not second-guess a legislature's eminent domain authorization so long as it is "rationally related to a conceivable public purpose." *Id.*, at 241. The Court also reaffirmed that this deference is not affected by the redistribution of land to private entities because the "public use" requirement is addressed to the goal of the condemnation, not the means by which it is achieved.

These cases supported and reflected years of fruitful private-public redevelopment partnerships across the nation, but such endeavors have faced substantial political protest and constitutional challenge along the way. The Michigan Supreme Court's decision in *Poletown Neighborhood Council* v. *City of Detroit* 410 Mich. 616 (1981), is one of the most widely cited state cases to address the "public use" requirement. *Poletown* extended the reach of "public use" beyond the mere clearance of blight to include the goal of "alleviating unemployment and revitalizing the economic base of the community." *Id.*, at 634. Relying on *Berman*, the *Poletown* case also held that a legislative decision to define "public use" in a manner that incidentally benefits private enterprise should not be disturbed by courts, so long as the public benefit articulated by the legislature is "clear and specific," rather than "speculative and marginal."

Poletown, however, was overruled in July 2004 by the Michigan Supreme Court in *County of Wayne* v. *Hathcock*, 471 Mich. 445 (2004), a case widely discussed by the *Kelo* petitioners in their Supreme Court brief. The plaintiffs in *Hathcock* were residents of Wayne County, Mich., who challenged the county's use of eminent domain to develop a large business and technology park around the county's newly renovated airport. The renovation and expansion of the existing airport raised noise concerns for the surrounding residents, leading the county to purchase about 500 acres of non-adjacent lots around the airport from voluntary sellers. The Federal Aviation Administration facilitated these purchases through a $21 million grant, which required all acquired properties to "be put to economically productive use." *Id.*, at 452. In response to this requirement,

the county proposed the business and technology park development plan, necessitating the condemnation of 46 private lots scattered among the lots that had already been purchased. A group of these homeowners sued, contending that the Michigan Constitution's "public use" requirement, having substantially similar language as the federal constitution, did not permit condemnation for the sole goal of generalized economic development through private venture. The county projected that the development plan would create 30,000 new jobs and add $350,000,000 in tax revenue.

The opinion discredits neither of these projections nor the claim that the plan would "broad[en] the County's tax base from predominately industrial to a mixture of industrial, service and technology [and] accelerate[ ] economic growth and revenue enhancement." Although the Michigan court found that the development plan would provide a "public benefit," it held that the project did not meet the "public use" threshold under the Michigan Constitution, distinguishing federal cases involving the federal constitution as not controlling.

The Michigan court disregarded *Poletown* and the years of other like-minded precedent in favor of the "original meaning" of the Michigan Constitution's "public use" terminology as understood by the ratifiers of the 1963 amendments to the Constitution. Parenthetically, the court described this methodology as "the primary objective in interpreting a constitutional provision." Based on an extensive discussion of the understanding of these ratifiers, the court held that government condemnation and subsequent transfer to a private entity are outside the scope of "public use" unless (i) the government's end goal will be impracticable without private transfer, as in the case of railroad development; (ii) the private owner will not be permitted to circumscribe the public's free use of the land; or (iii) the act of condemnation itself is in the public interest, such as in the case of clearing blight. *Id.,* at 474. Since the county's development plan was to be carried out by private entities, and the county did not profess to be clearing blight, the court held that the project did not meet Michigan constitutional requirements. As a matter of policy, the court observed that

> [e]very business, every productive unit in society, does . . . contribute in some way to the commonwealth. To justify the exercise of eminent domain solely on the basis of the fact that the use of that property by a private entity seeking its own profit might contribute to the economy's health is to render impotent our constitutional limitation on the government's power of eminent domain. *Poletown*'s "economic benefit" rationale would validate practically all exercise of the power of eminent domain on behalf of a private entity. *Id.*, at 482.

The Connecticut Supreme Court issued its opinion in *Kelo* just a month before oral argument in the Michigan case, reaching the opposite answer on the question of "economic development" as "public use." The state of Connecticut's office of policy and management has designated New London as a "distressed municipality" because the city has endured "serious employment declines" with the loss of 1,900 government sector positions in recent years as well as the closure of the U.S. Naval Undersea Warfare Center and the related loss of another 1,000 jobs. Catalyzed by Pfizer's 1998 announcement that it would build a global research facility adjacent to the Fort Trumbell area of New London, the city's public development corporation introduced a plan to develop approximately 90 acres on the Thames River in the Fort Trumbell area of the city. The plan's express goals are to "create development that would complement the facility that Pfizer was planning to build, create jobs, increase tax and other revenues, encourage public access to and use of the city's waterfront, and eventually "build momentum" for the revitalization of the rest of the city, including the downtown area."

The development plan includes the following projects: a marina area with a waterfront hotel and conference center; a residential area with 80 new units and an area designated for the U.S. Coast Guard Museum; an office space area designated for technology research; an area for "park support" relating to the adjacent state park; and an area for retail space. Although the public development corporation will retain ownership of the land, it intends to effectuate the plan by leasing parcels to private developers at a nominal fee. These leases will require the private developers to adhere to the terms of the development plan. "The development plan is expected to generate approximately between (1) 518 and 867 construction jobs; (2) 718 and 1362 direct jobs; and (3) 500 and 940 indirect jobs. The composite parcels of the development plan are also expected to generate between $680,544 and $1,249,843 in property tax revenues for the city, in which 54 percent of the land area is exempt from property taxes."

The *Kelo* petitioners are nine Fort Trumbell area property owners from seven families, whose homes and commercial property were designated for condemnation as part of the development plan. The City of New London claimed authority to exercise its eminent domain power in pursuit of the Fort Trumbell development plan under the Connecticut General Statutes' declaration "as a matter of legislative finding" that "permitting and assisting municipalities to acquire and improve unified land and water areas and to acquire and improve or demolish vacated commercial plants for industrial and business purposes . . . are public uses."

The petitioners challenged the constitutionality of this legislative definition under the federal and state constitutions, arguing that the development plan did not constitute a "public use" because the condemnations would not remove blight and the private lessees would "not provide a public service or utility." The Connecticut Supreme Court concluded, citing federal and state precedent, including *Berman* and *Midkiff*, that it must defer to the legislature's definition of "public use" to include economic development, even if the condemned lands will be transferred to and controlled by private entities. The court rejected the petitioners' contention that private developers would be the primary beneficiaries of the project, explaining that the city was economically depressed and that the project would undoubtedly ameliorate its economic health. In

particular, the court emphasized that the Fort Trumbell development plan included sufficient statutory and contractual land-use restrictions and oversight to assure private developers' adherence to the development plan.

Worthy of mention, the court distinguished a 2002 Illinois case, *Southwestern Illinois Development Authority* v. *National City Environmental*, 768 N.E.2d 1 (Ill. 2002) ("*SWIDA*"), that is cited by the *Kelo* petitioners in the Supreme Court. In *SWIDA*, the Illinois Supreme Court struck down the use of eminent domain to take private rural property in order to transfer it to a private racetrack for expansion of its parking lot. The court held that "while economic development is an important public purpose" and that attendees of races would benefit from the racetrack's parking expansion, the condemnation was intended primarily to benefit the private racetrack as evidenced by the lack of governmental regulation of the racetrack's use of the property. "While the activities here were undertaken in the guise of carrying out its legislated mission, [the agency's] true intentions were not clothed in an independent, legitimate governmental decision to further a planned public use." *Id.*, at 240.

The Connecticut Supreme Court in *Kelo* explained that the *SWIDA* decision did not reject economic development as a legitimate "public use," but instead determined that the particular economic development plan in that case could not "be said to be for the public's benefit" and that the facts of *SWIDA* "merely demonstrate[d] the far outer limit of the use of the eminent domain power for economic development."

On *certiorari* in the Supreme Court, the petitioners, who are represented by a libertarian public interest law firm,[2] contend that the Supreme Court's holdings in the *Berman* and *Midkiff* blight cases are not controlling because those decisions were based on the need to eliminate undesirable conditions, whereas the sole purpose of New London's condemnations is to increase its tax revenue and create jobs. They warn that if such economic gain is considered "public use," then all private homes will be susceptible to condemnation for transfer to private business because, as they state in their *certiorari* brief, "nearly all homes and small businesses generate fewer tax dollars and jobs than larger businesses." Effectively, they are asking the Court to hold that the goal of economic development is *per se* insufficient to warrant the use of eminent domain.[3]

The *amici* on the petitioners' side in *Kelo* warn of a similarly dire fate in the event that New London's eminent domain power is upheld. A large number of these *amici* are libertarian and property rights groups, including James Buchanan and Gordon Tullock, two prominent public choice economists who have devoted much of their careers to advocating against special interest control of the political process; the Pacific Legal Foundation, a non-profit organization dedicated to "limited government, and private property rights"; and the Property Rights Foundation of America, which is committed to "the fundamental constitutional rights of American citizens, especially the right to own and use property" without government interference. These *amici* argue that there is "no logical limit to redistributing property" from private party to private party, and the impact of upholding the type of condemnation proposed by New London will result in a Hobbes-described nightmare where "every person's property is as insecure as the laws of nature." *But see*, *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 416 (1922) (explaining that the takings determination in a particular case "is a question of degree—and cannot be disposed of by general propositions").

The extreme concerns voiced by the *amici* in *Kelo* and the Michigan court in *Hathcock* resonate to a deeply held fear of unbridled government power. Nonetheless, the benefits of the eminent domain power—in particular, the benefit of economic redevelopment, which not only changes an impoverished community's physical environment but also changes its residents' landscape of opportunity—should not be sacrificed for fear of its extreme and illegitimate use. Striking the balance between the individual's right to be free from condemnation that is not intended for "public use" and the state's right to condemn for "public use" requires just that—a balancing of factors, by its nature a fact-sensitive exercise not amenable to blanket rules. The Supreme Court should reject the temptation to adopt a blanket rule excluding economic development from the scope of "public use."

The Supreme Court need not devise a host of new factors or an original balancing test to address this issue because federal and state courts have been employing balancing approaches to the "public use" analysis as long as the government has been condemning property. However, the Supreme Court should take this opportunity to frame a cogent restatement of the law of "public use" by re-articulating some of the factors scattered among these opinions. Mindful of preventing a motivated use of eminent domain that is entirely private, the Court should emphasize three relevant factors:

First, a court should consider the degree of the locality's economic distress. The greater the economic need, the more secure a court can feel in the "public use" to be carried out by the implementation of an economic development plan. *Hathcock*, for example, would have been better reasoned, had the Michigan justices struck down the use of eminent domain on the ground that the county had not proved prior economic distress. The taking of land merely to economically reengineer a stable county for the sole purpose of increasing tax revenue may not constitute "public use"; however, it is "public use" to redevelop land in order to implement a public plan to pull a distressed area out of stagnation by creating needed jobs and putting money in the county's empty coffers. The circumstances in *Kelo* place it squarely within the latter category, as the petitioners do not contest the economically distressed state of New London.

Second, a court should ask whether the condemnation at issue is part of a comprehensive plan for economic redevelopment. It raises red flags when a state condemns property for the use of one specific private entity, such as the transfer of property to a single private company for the expansion of its parking lot, as was the case in *SWIDA*. It is unlikely that this isolated private enterprise would effect broad, trickle-down benefit to the public. However, if land is condemned and transferred to various private entities or for varied private enterprises pursuant to a broader development plan, the condemnation

is more likely to increase the wealth of a broader community of people. This is particularly true where, as in *Kelo*, each condemnation serves to effect a comprehensive redevelopment plan that is designed to provide public benefit.

Finally, a court should consider whether there will be any continued government involvement or oversight in the private entities' use of the condemned land. The petitioners in *Kelo* are right to highlight this issue, but they are not correct to advocate that there must be either continuous, hands-on control by the state or public access to the property as of right. It is enough for a private developer to provide contractual commitments to adhere to the state-created or approved redevelopment plan. In *Kelo*, the Connecticut Supreme Court held that the private developer had made sufficient contractual assurances that it would abide by the city's detailed and comprehensive redevelopment plan, which support the "public use" character of the plan.

The Court should not be misled by the ideologically driven efforts of far-right property rights advocates and far-left libertarians to hand-pick sympathetic plaintiffs and to highlight the few egregious cases of misuse of the eminent domain power.[4] The legal system is not broken in this respect, and the judiciary has not shrugged its responsibility to ensure that the exercise of eminent domain is not misused. Courts have always served, and continue to serve, as a check on the state's eminent domain power. The Illinois Supreme Court served this purpose in *SWIDA*. Other examples include a California district court's decision to strike down the taking of property owned by a church in order to build a Costco in its place,[5] or the Superior Court of New Jersey in Atlantic City's decision to prohibit the Casino Reinvestment Development Authority from condemning homes to facilitate Donald Trump's expansion of casino parking.[6]

Courts will strike down the state's "public use" determination when, as the *Midkiff* case states, the use is "palpably without reasonable foundation." Such is not the case every time eminent domain is proposed for the purpose of economic development— it is not the case in *Kelo*. Likewise, the Supreme Court should not hold that economic development is *per se* insufficient to constitute "public use."

While deference to the legislature is a common refrain in the corpus of "public use" case law, it has never been a blind deference. Judicial oversight has been effective, and there is no non-ideological justification to overhaul 50-plus years of "public use" precedent to excise the goal of economic development from the scope of "public use."

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1 *See, e.g., Brown* v. *Legal Foundation of Washington*, 538 U.S. 216, 231-232 (2003) (explaining that the Fifth Amendment only permits those taking that serve a "public use," as opposed to a "private use").
2 The Institute for Justice, located in Washington, D.C., has litigated numerous eminent domain cases throughout the country.
3 The petitioners argue in the alternative that the Court should strike down the specific use at issue in *Kelo*, even if it does not determine that the exercise of eminent domain for economic development is categorically unconstitutional.
4 Justice Harlan's warning that "it is the duty of all courts of justice to take care, for the general good of the community, that hard cases do not make bad law," *United States* v. *Clark*, 96 U.S. 37, 49 (1878) (dissenting opinion), rings particularly true in this case.
5 See *99 Cents Only Stores* v. *Lancaster Redevelopment Agency*, 237 F. Supp. 2d 1123 (C.D. Cal. 2001).
6 See Karen DeMasters, *It's Official: Trump Won't Get Atlantic City House*, *New York Times* 14NJ (Sept. 13, 1998).

Of Interest

Articles

John D. Ayer, Michael L. Bernstein and Jonathan Friedland, "Obtaining Dip Financing and Using Cash Collateral," 23-Sep *Am. Bankr. Inst. J.* 16 (September 2004).

John D. Ayer, Michael L. Bernstein and Jonathan Friedland, "Executory Contracts Under § 365," Nov *Am Bankr. Inst. J.* 16 (November 2004).

John D. Ayer, Michael L. Bernstein and Jonathan Friedland, "Bankruptcy Issues for Landlords and Tenants," 23-Oct *Am. Bankr. Inst. J.* 16 (October 2004).

Lisa S. Gretchko, "Debtor Beware! Fourth Circuit Enforces Restrictive Use Clause to Block Debtor/Tenant's Assignment of Shopping Center Lease," 23-Sep *Am. Bankr. Inst. J.* 18 (September 2004).

William McGrane, "Beware a False Sense of Security—Why Banks Should Think Twice Before Insuring Performance of Real Estate Leases," 23-Jan *Am. Bankr. Inst. J.* 28 (December/January 2005).

Richard E. Mikels, Adrienne K. Walker and Sara R. Bollerup, "Subordination Agreement Case Highlights Conflict With State Law," 23-Jan *Am. Bankr. Inst. J.* 12 (December/January 2005).

Thomas J. Salerno, "Memo to Tenants: If You're Going to Trash Leased Estate Property, Be Sure to Reject the Lease," 23-Jan *Am. Bankr. Inst. J.* 24 (December/January 2005).

Bruce H. White and William L. Medford, "Rejecting Executory Contracts: Is the Standard Changing?" 23-Oct *Am. Bankr. Inst. J.* 24 (October 2004).

Cases

Assignment/Sublease

A landlord did not unreasonably withhold consent to an assignment where the tenant failed to pay rent and related charges under the lease and where the use of the assignment sought by the tenant materially differed from the use specified in the lease. *Sayed* v. *Rapp*, 10 A.D.3d 717; 782 N.Y.S.2d 278, Supreme Court of New York, Appellate Division, Second Department, Sept. 27, 2004.

A landlord has an absolute right to withhold consent to an assignment of a lease where the lease does not require the landlord to act reasonably; where the tenant has failed to pay rent and other charges, and where there has been no modification of the lease, the landlord is not acting with malice by withholding consent to an assignment of the lease. *The Tap Room, Inc.* v. *Peachtree-TSG Associates, LLC,* 270 Ga. App. 90; 606 S.E.2d 13, Court of Appeals of Georgia, Second Division, Sept. 22, 2004.

A "proposed" sub-subtenant whose request to sub-sublease property is rejected by the primary landlord may not maintain an action against both the primary landlord and the primary tenant because there is no contractual privity; however, the proposed sub-subtenant may be able to maintain an action against the subtenant and implead the primary tenant. *Merle Wood & Associates* v. *Intervest-Quay Limited Partnership,* 877 So. 2d 942, Court of Appeal of Florida, Fourth District, July 28, 2004.

Bankruptcy

A debtor proposed to assume a shopping center lease and cure its default by making payments over a 48-month period. The court held that the payments, which would provide the lessor with the cure amount and interest at the rate of 6%, were not a "prompt cure" as required under § 365 of the Code. *In re Uniq Shoes Corp*., 316 B.R. 748 (Bkrtcy. S.D. Fla. 2004).

Following foreclosure, Chapter 13 debtor-property owner sued the holders of a second deed of trust, challenging the propriety of the foreclosure on the grounds that the notice of default incorrectly stated the amount of arrearages then owing. The court held that the notice of default included the correct amount of principal and interest and that attorney fees were properly included in the notice of default. *In re Atighi*, 317 B.R, 792 (Bkrtcy. C.D. Cal. 2004).

A supermarket on property adjacent to the debtor had standing to enforce a restrictive covenant against the assignee of the debtor. Under state law, the covenant ran with the land and could be enforced so long as the requirements were satisfied. Furthermore, the use restriction was not an unenforceable anti-assignment provision under the Bankruptcy Code. *In re Ames Dept. Stores, Inc*., 316 B.R. 772 (Bkrtcy.S.D.N.Y. 2004).

A facilities lease between a debtor airline and a state development authority was a true lease within the meaning of the Code's provision governing unexpired leases. There was no evidence that the debtor knew it would be filing for bankruptcy and that the lease would become an issue in dispute. Moreover, the debtor could not be equitably estopped from later asserting that the leases were disguised agreements. *HSBC Bank USA* v. *United Air Lines, Inc*., 317 B.R. 335 (N.D.Ill. 2004)

A landlord will not be awarded post-petition rent based upon the original lease or attorney fees where the landlord was notified of the debtor-tenant's intent to reject the lease and the landlord negotiated a reduced rent with the tenant. *In re: Nucentrix Broadband Networks, Inc., et al..*, 314 B.R. 581 (Bkrtcy.N.D.Tex. 2004).

Condemnation/Eminent Domain

A tenant cannot seek compensation in an eminent domain matter where the tenant contractually waived its right to share in any condemnation award in its lease with the landlord. *West Valley City* v. *Martin dba Fantastic Sam's,* 100 P.3d 248, Court of Appeals of Utah, Sept. 23, 2004.

Contracts

A broker may recover damages for breach of an agreement between itself and a landlord where the landlord fails to pay the broker's monthly retainer fee and where the agreement permits remedies in addition to those contained in the agreement. *Urban Retail Properties, Co.* v. *Talisman Brookdale L.L.C.,* A03-1877, Court of Appeals of Minnesota, Aug. 10, 2004.

Covenants

Where a sublease contains a covenant restricting the use of the subject premises to operation of a supermarket, the retailer may not open a pharmacy within the supermarket; it is not "custom" for a supermarket to operate a pharmacy. *Thrifty-Payless Inc.* v. *Ennen Food Stores, Inc., et al.,* 113 Fed. Appx. 797, U.S. Court of Appeals for the Ninth Circuit, Oct. 8, 2004.

A landlord may not be found to have breached the covenant of quiet enjoyment, even though the landlord may have engaged in more than one litigation to gain possession of the property, where the evidence does not show that the landlord pursued the litigation maliciously or in bad faith. *J. Carl Kohl* v. *PNC Bank National Association,* 863 A.2d 23, Superior Court of Pennsylvania, Nov. 5, 2004 (as amended).

Fees

A landlord may not be entitled to attorney fees where the lease provides that the landlord can collect fees only if the tenant is in breach of the lease or if the landlord is seeking enforcement of any terms of the agreement. *Smith et al.* v. *Crossman,* No. M2003-01108-COA-R3-CV, Court of Appeals of Tennessee, Aug. 2, 2004.

Landlord and Tenant

Although the HVAC system was located in the ceiling outside the leased premises and not within the leased premises, the court found that a tenant may be responsible for HVAC repairs if the lease places such responsibility with the tenant, even if a portion of the repairs occurs outside of the leased premises. *Chelsea GCA Realty Partnership, L.P.* v. *Pilgrim Silk Flowers, Inc*., Case No. 2003-P-0013, Court of Appeals of Ohio, Eleventh Appellate District, Portage County, Sept. 30, 2004.

If a tenant does not object to the completeness of the documents produced pursuant to a subpoena *duces tecum* during trial, the trial court may not rule in favor of the tenant on the basis of fundamental unfairness; it is the tenant's responsibility to make its own objection. *TA Realty Associates Fund V, L.P.* v. *NCNB 1500 Inc.,* 144 S.W.3d 343, Court of Appeals of Missouri, Eastern District, Division Three, Sept. 21, 2004.

A landlord may not be found to have acted in bad faith if the landlord seeks nominal increased rent from a sublessor and if it is established that the sublessor would have considered paying the nominal increase in rent. *Galouzis* v. *Dorr*, 565519, Superior Court of Connecticut, Judicial District of New London, at New London, July 20, 2004.

If a subtenant has paid its rent in full, a subtenant's damages for breach of the lease by the landlord should be calculated by the actual rental value of the portion of the property lost as a result of the breach; the determination of the actual rental value may require expert testimony. *Appliance Giant, Inc.* v. *Columbia 90 Associates,* LLC, 8 A.D.3d 932; 779 N.Y.S.2d 611, Supreme Court of New York, Appellate Division, Third Department, June 24, 2004.

The tenant had accumulated water bills due to the town, but failed to pay the town. The town notified the landlord that the water bills were the landlord's responsibility and that, in order to shut off water to the tenant, it would have to shut off water to the entire shopping center. The landlord commenced an action for a declaratory judgment seeking to determine the legal rights and obligations of the town, the landlord and the tenant. The court held that if there is an adequate remedy at law and there is no uncertainty of legal relations between the parties, a court may find that the issues before it are not suited for resolution by declaratory judgment. *Woodgreen Portland Limited Partnership* v. *Town of Portland*, CV020098499S, Superior Court of Connecticut, Judicial District of Middlesex, at Middletown, June 1, 2004.

Leases

Where a lease does not require a landlord to provide security services, a tenant could not vacate the premises on the basis of lack of security that resulted in armed robbery and the departure of anchor stores that affected the tenant's foot traffic. *Charlotte Eastland Mall, LLC* v. *Sole Survivor, Inc.,* No. COA03-1422, Court of Appeals of North Carolina, Oct.19, 2004.

A landlord may not impose a late fee on unpaid common area maintenance fees if the lease only provides for an imposition of a late fee on rent; a tenant is not obligated to continue to pay a monthly sign fee if the lease provides that the fee is optional and does not specify any procedure for terminating payment of the sign fee. *Haar* v. *Glover,* 2030193, Court of Civil Appeals of Alabama, Sept. 24, 2004.

A court may find that a valid lease exists where a prior lease terminates and one party executes a new lease under which the parties continue to operate; it may be inferred by the actions of the parties that each was operating as though a valid lease existed. *Enterprise Property Grocery, Inc.* v. *Selma, Inc.*, 882 So. 2d 652, Court of Appeal of Louisiana, Second Circuit, Sept. 22, 2004.

In a dispute between two parties to a lease over property left behind when the leased premises were vacated, the court ruled that the doctrine of *res judicata* may apply in a federal action commenced after a state action is dismissed with prejudice, and where the same cause of actions is alleged against the same parties, even if the plaintiff added one claim and some additional parties in the federal action. *Jett* v. *Beech Interplex, Inc*., Civil Action No. 02-9131, District Court for the Eastern District of Pennsylvania, July 15, 2004.

After a tenant tried numerous times to cure a default, the court held that a *Yellowstone injunction* that enjoins the landlord from terminating a tenancy may be granted if the tenant shows it is ready, willing and able to cure the default, even if the tenant argues that it had already cured the default and no further action was needed. *TSI West 14* v. *Samson Associates*, LLC, 8 A.D.3d 51; 778 N.Y.S.2d 29, Supreme Court of New York, Appellate Division, First Department, June 8, 2004.

Tort Liability

Summary judgment may not be granted in favor of a landlord in an action for damages and injuries where an issue of fact exists surrounding whether the landlord or the tenant controls the parking lot where the incident occurred. *Robles et al.* v. *Kings Highway Realty,* Superior Court of Connecticut, Judicial District of Fairfield, at Bridgeport, Sept. 7, 2004.

A plaintiff may not maintain an action for personal injury against a lessor who does not retain control over the premises leased to the lessee, even if the lease permits a right of re-entry by the lessor for certain maintenance and emergencies. *Gardner* v. *Ralph and Rich's,* 385057, Superior Court of Connecticut, Judicial District of Fairfield, at Bridgeport, July 19, 2004.

Where a lease unambiguously requires the landlord to be responsible for security in the common areas of a shopping center, the tenant may not be found liable for premises liability, even where the landlord specifically does not guarantee against acts of vandalism or other criminal acts. *Alarcon* v. *Bed, Bath & Beyond, Inc.,* No. 04-03-00551-CV, Court of Appeals of Texas, Fourth District, San Antonio, June 30, 2004.

Worker's Compensation

An employee may not be entitled to worker's compensation where the employee is injured in a common parking lot used by the employer and the other retail stores in the strip mall, and where the common parking lot is owned and maintained by the landlord rather than the employer. *Cleveland* v. *Food Lion, LLC #0578 and Risk Management Services, Inc.,* Record No. 2615-03-4, Court of Appeals of Virginia, Aug. 3, 2004.

Legislation

Colorado—2004 New Laws, H.B. No. 1203, limits the circumstances under which property acquired by eminent domain may be subsequently transferred to a private party.

Connecticut—2004 New Laws, S.B. No. 448, amends the state's vested rights statute to clarify that any construction on a vacant lot for which there is an approved subdivision or re-subdivision plan is not required to conform to later zoning changes.

Tennessee—2004 New Laws, S.B. No. 348, amends state law exempting the continuation, expansion or reconstruction of existing industrial, commercial or other business uses from subsequently enacted zoning regulations.

Vermont—2004 New Laws, H.B. No. 175, consolidates and clarifies provisions for the appeal of environmental permits.

Not Every Transfer Triggers a Tenant's Right of First Refusal to Purchase

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A right of first refusal ("ROFR") is an important inducement and a valuable tool for prospective tenants. In essence, it is a right held by a tenant to be the first in line to purchase a property should the landlord choose to sell. The ROFR may be in the form of an agreement whereby the tenant has the first chance to "match" another purchaser's offer, or it may be a stipulation that the tenant has the opportunity to buy the property at a fixed price when and if the landlord decides to sell. Either way, it is a valuable right because it not only provides a tenant with the opportunity to buy a property at a pre-determined and potentially below-market price, but it also allows tenants to protect their investment in the premises.

There are many ways to draft a ROFR, and although diligent drafting might capture most scenarios, there may be circumstances that might not be specifically contemplated. In these situations, courts will generally look beyond the fine print and ascertain the true intention of the parties. Thus, although a provision might seem to trigger a ROFR, one must consider whether the parties had truly intended the ROFR to be triggered in that particular circumstance. A recent Ontario decision illustrates this point well. *Jose Maria Tavares Enterprises Ltd.* v. *Salvatore Caruso and Desaro Holdings Inc.*, Ont. Sup. Ct. J. File No. 02-BN-10537 (unreported).

Salvatore (Sam) Caruso, a 72-year-old semi-retiree working a few days a week, had amassed a nest egg for his family over his years in the hairdressing business. He owned a building on Jane Street, in Toronto, where his salon was located. He owned another small commercial building on Lakeshore Road in Mississauga, which he had purchased in 1974. These two buildings had been purchased as investments to see Caruso and his family through his retirement. Jose Maria Tavares Enterprises Ltd. was Caruso's tenant at the Lakeshore Road property since 1985, operating a restaurant known as "The Great Canadian Pizza Company."

The lease between Desaro Holdings Inc., a company controlled by Caruso (who held the only voting shares) and Tavares, included a ROFR to purchase in favour of Tavares. The ROFR stated that the right would be triggered if Caruso received a bona fide offer to purchase the property that Caruso was prepared to accept.

In the fall of 1999, Caruso decided to engage in some tax and estate planning. As a result, an estate tax-freeze transaction caused both the Jane Street and the Lakeshore Road properties to be transferred to Desaro Holdings Inc., a company controlled by Caruso (who held the only voting shares). Caruso's wife and children held non-voting shares in Desaro.

The transaction was structured as a rollover, with the consideration for the transfer of the Lakeshore Road property to Desaro being, as set out in the land transfer tax affidavit, $250,000. The consideration was not paid in cash, but by preferred redeemable shares in Desaro. The transaction was structured to allow for the preference shares to be redeemed whenever Desaro had surplus cash flow to pay the taxes. The intention of the transaction was to reduce the amount of tax payable by Caruso's estate as a result of the deemed disposition of real estate upon his death.

Tavares claimed that Caruso's sale to Desaro triggered the ROFR in Tavares's lease. Tavares claimed that he did not learn of the transaction for over two years, by which time the property was worth more than $400,000. Tavares commenced an action, claiming that Caruso should have sold the property to Tavares for $250,000 and that Tavares was entitled to a conveyance from Desaro in exchange for that sum.

Caruso argued that there was never any bona fide offer to purchase the property. There was no offering of the property to the public or any solicitation of offers. It was a non-arm's-length transaction for estate planning purposes. As Caruso testified in court, the sale was "from Sam to Sam."

The court noted that ROFRs to purchase are contractual rights. Once the right is triggered, it converts to an option to purchase, which is an interest in land. The contractual right expires when the lease expires. An interest in land continues after lease expiry. At law, if the property is conveyed to a third party contrary to the option, the third party (in this case, Desaro) could be compelled to transfer the land to the party holding the option to purchase (in this case, Tavares). Tavares claimed that he had an option to purchase triggered by Caruso's transfer to Desaro. Tavares argued that Desaro's relationship to Caruso was of no consequence because the ROFR clause did not make this distinction. The ROFR only called for a transfer to be bona fide, which the Caruso-Desaro transfer was, as it was recognized by federal income tax authorities and the Ontario Ministry of Finance as a transfer with tax consequences.

The trial court disagreed with Tavares on two counts: (1) it found that the interpretation sought by Tavares would generate an unreasonable outcome, allowing Tavares to enjoy the appreciation in the property at the expense of Caruso. (2) The court found that at the time the provision in the lease was negotiated, the intention of the parties was that the ROFR would only be triggered on a sale to a third party. Furthermore, the ROFR was not triggered because there was no offer to purchase the property. Thus, the ROFR was never converted to an option and Desaro was allowed to keep the property.

Although this story has a happy ending for the Caruso family, and one that most readers would be satisfied with as achieving a fair and proper resolution of the dispute, the fact is that it was never a "slam-dunk" that Caruso would win. There is plenty of case law that holds that a single property can be carved out of a transfer of multiple properties for purposes of satisfying a tenant's ROFR, even if the purchase price is for the entire group of properties without any separate allocation.

For instance, in *Municipal Savings & Loan Corp.* v. *Oswenda Investments Ltd.*, the court held that a ROFR cannot be avoided simply by the landlord's addition of properties to the agreement for sale. On the other hand, there is also case law that comes to the opposite conclusion. In *Budget Car Rentals Toronto Ltd.* v. *Petro Canada Inc.,* the court held that a right of first refusal ROFR was not triggered where the landlord, Petro Canada, entered into an asset sale in respect of all its assets.

There is also case law that a transfer to a related entity does not defeat a ROFR, nor can the transferor give the property away to defeat the ROFR. In *Gardner* v. *Coutts & Company*, for instance, the vendor had made a gift of the subject property to his sister without offering it to the holder of the ROFR. The court held that it was implicit in the grant of the ROFR that the landlord should not be allowed to give the property away without first offering it to the tenant, which would effectively defeat the ROFR.

So, what type of transfer or sale triggers a ROFR to purchase? As lawyers are wont to say: "It depends." The starting point of any analysis is, of course, the clause itself. Typically, a clause will call for an offer from a "bona fide" purchaser. The phrase "bona fide" means "good faith," which is usually defined as the absence of bad faith or the absence of purpose to take unfair advantage of third persons. As *Desaro* shows, application of the term "bona fide" will depend on the facts of a given situation.

While an "offer" to purchase can take many forms, that offer need not come from a third party unless the clause so states or the intention of the parties is later determined to have been so limiting. If the clause does not address every issue, the courts will have to make a determination based on legal principles and the laws of interpretation. Courts will attempt to piece together the commercial setting in which a lease was negotiated. However, many of the difficulties associated with ROFRs arise in matters of interpretation. It is, therefore, wise to eliminate as much of the uncertainty as possible.

ROFRs are an infrequent insertion in most leases. Nonetheless, when such a right is negotiated, parties need to consider whether every "sale" will trigger it. A landlord may want the opportunity to make a change that, although technically a sale, is in fact merely a change in the form of ownership. Parties should, therefore, consider whether related-party transfers trigger the right, whether the triggering offer must be in writing, whether a portfolio sale is caught by the right and whether the transfer must be only for cash consideration to be subject to the right. The interpretation of these clauses will certainly be easier if these issues have been addressed at the outset.

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From Canada

In Depth

Judicial/Legislative Developments

Cases

ALBERTA

A national tenant sought protection under *The Companies Creditors Arrangement Act*. The landlords argued that they should be placed in a separate class from the unsecured creditors because they have distinct legal rights, as their claims are difficult to value and they are preferred over the other creditors in the class. The landlords claimed that their distinct legal rights were the following: (i) the right to follow and seize assets removed from abandoned premises; (ii) the right to claim damages against any person who aided the tenant in the clandestine removal of goods from the premises; and (iii) the right to terminate a lease for default pursuant to the insolvency clauses of each lease. The court held it did not believe that ordering a separate class for the landlord was appropriate, as it would, in essence, give the objecting landlords veto power on the plan. However, the court did order that the plan should be amended to preserve any cause of action the landlords might have against any third party that may have aided the tenant in clandestinely removing goods from the leased premises. *Re San Francisco Gifts Limited (The Companies Creditors Arrangement Act)*, 2004 A.B.Q.B. 705.

BRITISH COLUMBIA

The plaintiff was the landlord of commercial properties seeking a judgment for arrears of rent where parole evidence is inadmissible to contradict the lease. The landlord was entitled to claim rent calculated in accordance with the lease, rather than in accordance with the agreement to lease. *Publico Properties Company* v. *C.P.I. Creative Play Industries, Coquitlam Ltd.*, 2004 B.C.S.C. 190.

The tenant claims the landlord made misrepresentations that induced the tenant to lease the business premises for commercial purposes. The plaintiff tenant was able to prove the existence of a collateral oral agreement that the defendant's premises would be rezoned commercially and would be renovated. *Clearbrook Brewing Company Ltd.* v. *Filuk Holdings Ltd. et al.*, 2004 B.C.S.C. 515.

There is no evidence that a five-year lease created a month-to-month tenancy upon expiration of the lease. Rather the tenancy became a year-to-year tenancy. *Brutus Holdings Ltd.* v. *Quesnel Pharmacy Ltd.*, 2004 B.C.S.C. 292.

An application to dismiss a subrogated claim brought by a landlord against a tenant for damages caused by a fire will be dismissed where the terms of the lease, despite a covenant to insure, indicate an intention that the landlord is entitled to recover, in the event of the tenant's negligence causing loss. *North Newton Warehouse Ltd.* v. *Alliance Woodcraft Manufacturing Inc.* [2004] B.C.D. civ. 325.40.20.30-31.

The plaintiff company owns a combination strip mall/R.V. park/restaurant, etc. The plaintiff landlord leased a bar to tenants who removed the landlord's personal property from the bar. The court ruled in favour of the plaintiff, even though the list of equipment was not attached to the lease. *Village Services (1968) Ltd.* v. *Sharon Grace Clarke et al.*, 2004 B.C.S.C. 1167.

The B.C.C.A. upholds the B.C.S.C.'s decision that overturned the arbitrator's decision. It was determined that use restrictions contained in a lease must be considered in determining the fair market value for rent. The landlord cannot determine fair market value based on unrestricted use of the lands when the tenant is precluded from enjoying what may be the highest and best use. *Pacific West Systems Supply Ltd.* v. *B.C. Rail Partnership*, 2004 B.C.C.A. 247.

A lease cannot be renewed and a landlord cannot be entitled to possession when the tenant has been struck from the registrar of companies. *Roche Properties Ltd. and Daisen Management Ltd.* v. *440402 B.C. Ltd. and Terry Vincent*, 2004 B.C.S.C. 687.

When the landlord unreasonably withholds consent to allow the tenant to sublet a portion of the premises, consequently contributing to the tenant's bankruptcy, the landlord cannot sue the indemnitor of the lease, since the actions of the landlord increase the risk of the indemnitor. *Jens Hans Investments Co.* v. *Doctor David Bridger*, C.A. 030117 B.C.C.A.

The landlord is seeking damages on the basis of a present recovery of losing the benefit of the lease of the premises to the tenant over its unexpired term. As a result of the departure of one of the lawyers from the partnership, the tenant failed to pay three months' rent. This was not a case of surrender, within the meaning of the authorities prior to the Supreme Court of Canada's decision in *Highway Properties Ltd.* v. *Kelly Douglas & Co. Ltd.*, but rather one in which the landlord elected to terminate the lease and retake possession on notice that it would seek prospective damages for the unexpired portion of the term. *491506 B.C. Ltd.* v. *McElmoyle*, 2004 B.C.S.C. 1075.

MANITOBA

The plaintiff owned a parcel of land containing a restaurant and a gas station, which it leased to an individual named Reid, who contracted for certain repairs that were performed by the defendant. When the defendant was not paid for this work, it filed a lien against the title of both the car wash and the restaurant, combining the debts for the most recent work and work

completed on the restaurant but never paid for. As to the first issue, the court declared that the plaintiff could be held liable for the acts performed by Reid, based on the fact that it was aware that Reid would be unable to pay for the work that was being performed and that the plaintiff, therefore, had engaged Reid as its agent to hire defendant. The second issue was whether the lien was valid, considering that its balance was inflated by combining the two jobs, where the second job added to the balance could no longer be claimed for through a lien. The court stated that, because the accounts were segregated in the statement of claim, there was no problem with the lien made by the defendant. *Reicheneder v. Wheatland Plumbing & Heating Ltd.,* 2004, M.B.Q.B. 203.

Keg and Kraft were liable to the landlord of the property for rents due. In dispute, among other things, was whether Keg and Kraft were also liable for both the original premises and the expanded portion. At issue were the following: breach of contract due to (i) overcharging of rent; (ii) the refusal to consent to reassignment; (iii) violation of a restrictive covenant; (iv) the breach of a good-faith duty; and (v) the failure to mitigate losses by the plaintiffs. Regarding the overcharging, the court stated that all issues had been resolved as a result of appropriate adjustments that had been made. Regarding the second issue, the court found that consent had, in fact, been given. The third issue, the restrictive covenant, was found to be without foundation. Fourth, in regard to the issue of good faith, the court determined that while the good faith may not have been very strong, there was no presence of bad faith. Finally, regarding the issue of mitigation, the court determined that the plaintiffs may not have made the most concerted effort, but the effort was sufficient to prove that the plaintiffs did not fail to mitigate their damages. *PensionFund Realty Ltd.* v. *Keg Restaurants of Manitoba Ltd.*

ONTARIO

Upon entering into a lease agreement, the tenant asked the landlord whether the applicable zoning by-laws permitted the operation of a used car business. Without verifying the by-laws, the landlord assured the tenant that there would be no problem, based on the landlord's knowledge of the by-laws when it purchased the property. After signing the lease, the tenant discovered that the zoning by-laws had been amended and it was, therefore, not allowed to operate a used car business on the premises. The landlord had not been aware of this amendment. The tenant elected not to take possession of the premises. The landlord sued, seeking damages for the tenant's breach of the lease agreement. The court ruled in favour of the tenant. The landlord was deemed negligent and careless in assuring the tenant that the zoning by-laws would permit a used car business on the premises. Moreover, the landlord was aware that the tenant relied on its assurance in signing the lease. The court, therefore, held that the tenant was entitled to treat the lease as at an end, and the landlord was ordered to return all amounts that it had received from the tenant. *Chung v. Merrikhi* [2004] O.J. No. 1676 (Ontario Superior Court of Justice—Small Claims).

This case involved the interpretation of a use clause contained in a lease. The tenant inferred that the use clause permitted any retail use, while the landlord argued that the lease only permitted the premises to be used for a grocery store and other retail uses ancillary to the grocery store operation. The court ruled in favour of the landlord, holding that the use clause should be read conjunctively, not disjunctively. Accordingly, the other retail uses were limited to those uses that were ancillary or supportive of the primary grocery store use. 1*536165 Ontario Limited* v. *City of Toronto Economic Development Corp.* [2004] O.J. No. 1151 (Ontario Superior Court of Justice Divisional Court).

The lease required the tenant to surrender the premises at the end of the term in a good state of repair and restored to the original condition. This obligation was subject to reasonable wear and tear that would be incurred during the term. At issue was the extent of the repairs and restoration to be undertaken by the tenant. The lower court essentially accepted the cost put forward by the landlord's consultant, but discounted the amount by 35% to take into account the reasonable wear-and-tear exception. The Court of Appeal concurred with the lower court that an exception for reasonable wear and tear was available to the tenant. However, the Court of Appeal was of the view that the burden of proof rested with the tenant to establish the amount of the wear-and-tear reduction that should be made to the landlord's proven damages. The Court of Appeal found that the tenant failed to discharge its evidential burden, as it did not adduce any evidence to support a 35% or other reduction. *Stellarbridge Management Inc.* v. *Magna International (Canada) Inc. et al.* [2004] O.J. No. 2102 (Ontario Court of Appeal).

The tenant was prohibited from directly or indirectly owning, operating, financing or participating in any competitive business within 5 kilometers of the landlord's shopping centre. The landlord argued that the restriction was breached by the fact that a corporate affiliate of the tenant operated a competing store in another shopping centre less than 5 kilometers away, under the same trade name that the tenant used for the premises. The tenant and its corporate affiliate were both subsidiaries of the same parent company. The court ruled in favour of the tenant, holding that the separate identities of the tenant and its corporate affiliate could not be ignored. In the court's view, absent fraud or improper conduct, the separate identity of the two corporations had to be recognized and respected. In this regard, the factual circumstances surrounding this case indicated that the use of the different corporate tenants by the parent company was not intended to circumvent the radius restriction in the lease. *Vanreal Properties Ltd.* v. *Erisan Inc.* [2003] O.J. No. 4701 (Ontario Superior Court of Justice).

The landlord and the tenant signed an offer to lease, which contained a restoration provision. However, when the landlord's solicitor drafted the lease, he mistakenly omitted it. When the tenant indicated it would vacate the premises, the landlord requested that the premises be restored. The tenant, however, refused since the lease did not contain a restoration provision. The landlord applied to the court for rectification of the lease, requesting that the court bring the lease into harmony with the offer. At issue was whether the offer was a contract that could be used to rectify a subsequent contract, the lease. The

court held that the offer was indeed a contract. The preparation of the lease was a mere formality, and the document was a standard form lease incorporating all the terms of the offer. While either party could have suggested reasonable changes, neither could suggest substantial changes to the terms of the offer. Accordingly, the court ordered that the lease be rectified to include the restoration provision contained in the offer. *Enticor Properties Inc.* v. *Quick-Run Courrier Ltd.* [2004] O.J. No. 1883 (Ontario Superior Court of Justice).

After the expiration of the lease where the tenant failed to properly renew the lease, the landlord advised the tenant that it was willing to renew the lease for five years and set out the proposed rent during the renewal. The tenant counter-offered, but the landlord refused it, reaffirming instead its original offer. After several weeks of unsuccessful negotiations, the landlord wrote a letter to the tenant, notifying it that the original offer was withdrawn and the lease terminated. Although the tenant immediately wrote back accepting the original offer, the landlord nevertheless refused to renew the lease and sought to remove the tenant. At issue was whether the landlord successfully withdrew its initial offer. While the lower court granted the tenant relief from forfeiture, the Court of Appeal upheld the lease renewal on two different grounds. First, since the landlord had waived the written notice requirement of the lease, it was bound by the provisions that dealt with rental renewal—in particular, the provisions that required arbitration in the event of disagreement over the rental rate upon renewal. Second, it was not clear from the landlord's letter that the original offer had been withdrawn. Because negotiations were ongoing at the time, both the letter and the surrounding circumstances were ambiguous. *1357277 Ontario Inc. (c.o.b. as Pape Village Coin Laundry)* v. *Grekos* [2004] O.J. No. 2535 (Ontario Court of Appeal).

The plaintiff was a supplier of both juice concentrates and machinery to the tenant who was a nightclub operator. The tenant defaulted in the payment of rent and the landlord distrained on all the goods in the premises, including certain equipment belonging to the tenant supplier. The supplier demanded the return of its equipment from the landlord. The landlord refused to return the equipment unless the supplier paid $400 in bailiff's fees to the landlord. The supplier eventually paid the $400; however, the landlord still refused to return the equipment. When the landlord eventually returned the equipment to the supplier some 27 months later, its value had diminished from approximately $14,000 to $1,000. The court held that the landlord wrongfully distrained upon the supplier's equipment, contrary to § 31(2) of the Commercial Tenancies Act. The supplier was awarded damages for the total loss of the value of the equipment. The court also imposed punitive damages against the landlord in the amount of $5,000, due to the landlord's unusual and confusing demand for the $400. *Pot'N'Juice Inc.* v. *1203891 Ontario Ltd.* [2004] O.J. No. 3085 (Ontario Superior Court of Justice).

QUEBEC

On April 1, 2004, the Supreme Court of Canada denied leave to appeal to the City of Quebec regarding Hudson Bay Company's motion for declaratory relief. This, therefore, confirmed that the tenant who occupies a portion of the shopping centre has the right to consult the documents prepared by the municipal assessor used as a basis for an entry on the assessment roll, even if the tenant's premises do not constitute a separate entry on the assessment roll. This was determined, based on the definition of "occupant" provided in § 79, para. 2, of *An Act Respecting Municipal Taxation*. It was, therefore, confirmed that the Hudson Bay Company, as a tenant, had the right to documents prepared by the municipal assessor, used as the basis for an entry on the roll, but was otherwise prohibited from requesting any other documents. *Ville de Québec c. Hudson Bay Company and Ivanhoe Inc., Omers Realty Corporation and Place Fleur de Lys (Intervenors).*

A Jehovah Witness Congregation had requested a change in the by-laws in order to build a place of worship. The municipality refused permission based on the specific context of the situation. While the municipality's first refusal to modify the zoning by-laws was explained by the fact of its negative impact on the taxpayers of the sector, the congregation's second and third requests were denied without any explanation. The Supreme Court determined that there had been an absence of procedural fairness in the second and third refusals by the municipality, and that the congregation had a right to equity during the process. This obligation of procedural fairness is connected to the importance of administrative decisions being answerable. In light of this analysis, the majority of the Supreme Court considered that the municipality had failed in its responsibilities of procedural fairness *vis-à-vis* the congregation by not justifying its decisions. Therefore, the municipality had to reconsider the congregation's third request and respond in detail, because giving a response without any reasoning could give the appearance of discrimination. *Congrégation des Témoins de Jéhovah de St-Jérôme—Lafontaine c. Lafontaine (Village de).*

The court was required to hear penal complaints regarding the contravention of zoning by-law concerning signs and billboards. The accused admitted to all the facts of the accusations, but contended that it had the right to post more signs than permitted as a result of the need to inform its clientele and to exercise its freedom of expression as provided for under *The Canadian Charter of Rights and Freedoms*. While the court recognized that the City can legally adopt any by-law to determine the norms for signs or billboards located within its territory, it also determined the need to deliberate as to the possibility of the accused being restricted by the by-laws in its rights to freedom of expression. In the end, the court recognized the validity of the by-laws, recognizing that the prevention of visual pollution is a reasonable objective that should be respected when the by-laws do not produce a disproportionate consequence in relation to the benefits being sought or desired. The court also stated that the City's by-laws do not contain anything that pertains to the content of communications or in any way inhibits their transmission. Therefore, the City's by-laws constitute a minimal infringement on the individual's rights to freedom of

expression and are, therefore, a reasonable limitation that cannot be considered in conflict with the charter. *Alma (Ville d') c. Entreprises M.T.A.*

The plaintiff had the intention of developing a ski resort, a golf course and a residential community. Financial problems, however, caused the project to be delayed. During the delay, a new city council came into power, composed of citizens opposed to the project. The new council then made changes to the zoning by-laws requiring the presentation of a development plan and the construction of a public road bordering the project. The plaintiff contends that the council's actions were in bad faith. The Supreme Court stated that the change of zoning by-laws by the municipality does not create responsibility for the City if it acted in good faith, even if the value of the property was diminished. The City benefits from a margin of error, and it is the plaintiff's burden to demonstrate the City's bad faith. Furthermore, the Supreme Court emphasized that, even though the plaintiff had already obtained construction permits, the works had not yet been done and the permits were eventually permitted to expire. Thus, the plaintiff cannot argue, in changing the zoning by-laws, that the City caused the project to fail, when in fact, the City's by-laws were changed after the expiration of the permits. Therefore, the plaintiff is solely responsible for the project's failure. *Entreprises Sibeca Inc.* v. *Frelighsburg (City of).*

The plaintiffs seek a declaration that the special property tax levied by the respondent on immovables is unjust since the municipality became the owner of an immovable included in the area subject to the tax because, as property of the municipality, the immovable became exempt from the property tax. The court determined that the municipality itself must support the loss of taxes that would have been levied on the immovable until the amortization of the loan is complete. To put the stability of the municipal finances in jeopardy is unfair to the applicants. The respondent chose to protect its claim without any bad faith being involved; however, it must accept the consequences of its decision.

The existing taxes would have otherwise been levied on the immovable. If the municipality had not decided to take the property in support of what it was owed, that immovable would have shared in the tax burden. The court ordered the respondent to reimburse the sum that was overpaid by the plaintiffs and re-established the tax to its original proportions, taking into consideration the property the municipality now owns. *3851885 Canada Inc.* v. *Notre-Dame-des-Prairies.*

The tenant signed a lease where the floor plans were not yet completed. However, it was understood that this phase of the project would be a separate building from the other phases already completed. At a later date, the developer decided that the new phase would be built attached to the prior phase by an adjoining wall, with doors in the wall so as to allow passage between the two phases on every floor. The court determined that the fact that the tenant relied on and accepted the developer's decisions regarding planning of the new phase cannot be interpreted as an acceptance of financial obligations resulting from the change in the plans that the tenant could not have been aware of at the time of the signing of the floor plans in 1999 and 2000. It also could not be concluded that the tenant was willing to amend its lease and to assume the additional financial obligations just because the two phases would now be attached, as opposed to the original plans where they would be separate buildings. *Tecsys Inc. c. Société en commandite CDTI de Montréal*, Court of Appeal.

Wise Stores Inc. acquired People's Department Stores Inc. from Marks & Spencer (Canada). The Wise brothers were majority shareholders, officers and directors of Wise and the only directors of People's. Because of covenants imposed by Marks & Spencer, People's could not be merged with Wise until the purchase price had been paid in full. Almost from the outset, the joint operation of Wise and People's did not function smoothly. In an effort to resolve the problems, the Wise brothers agreed to implement a joint inventory procurement policy whereby the two firms would divide responsibility for purchasing. People's would then transfer to Wise what it had purchased for Wise, charging Wise accordingly, and *vice versa*. Within a year of implementing the new policy, both Wise and People's declared bankruptcy. People's trustee filed a petition against the Wise brothers, claiming that they had favoured the interest of Wise over People's, to the detriment of People's creditors, in breach of their duties as directors under § 122, para. 1, of *The Canada Business Corporations Act*. In the alternative, the trustee claimed that the Wise brothers had, in the year preceding the bankruptcy, been privy to transactions in which People's assets had been transferred to Wise for conspicuously less than the fair market value, within the meaning of § 100 of *The Bankruptcy and Insolvency Act*. The trial judge found the Wise brothers liable on both grounds. The Court of Appeal set aside the trial judge's decision. The Supreme Court of Canada held that the appeal should be dismissed. The Wise brothers did not breach their duties under § 122, para. 1, of *The Canada Business Corporations Act* nor were the impugned transactions in violation of § 100 of *The Bankruptcy and Insolvency Act*. *In the matter of the bankruptcy of People's Department Stores Inc.*

SASKATCHEWAN

Does a taxpayer who wishes to appeal a tax assessment to a Board of Revision have the right to appeal a decision of the secretary of the Board to not put the taxpayer's appeal on the list for hearing by the Board? If the decision of the secretary was a decision of the Board within the meaning of § 260 of The Urban Municipality Act (1984), the taxpayer has a right to appeal the decision of the Committee. The court held that the position of a secretary is not a statutory office separate from that of the Board and that the secretary's powers, when exercised, are acts of the Board. *Prince Albert (City)* v. *RioCan Holdings Inc. and Saskatchewan Assessment Management Agency.*

ALBERTA

Due to the upcoming provincial election, there are no legislative developments to report at this time.

BRITISH COLUMBIA

The following developments have taken place in this province:

Bill 2—Business Practices and Consumer Protection Act, S.B.C.: 2004: The business practices and consumer protection authority has the power to carry out some or all of the functions and duties of a director under Bill 2. The collectors of debt cannot continue to communicate with a debtor, except through the debtor's lawyer, providing the collector has been notified to communicate with the debtor's lawyer and has been provided the proper information to do so.

Bill 4—Business Practices and Consumer Protection Act, S.B.C.: 2004: Bill 4 sets out the governing structure of the authority. It also regulates conflicts of interest, provides for officers and employees, and lays down financial requirements for the administration of the authority.

The Miscellaneous Statutes Amendment Act (No. 2), 2004, S.B.C.: 2004, c. 51 (Bill 54), amends the following statutes:

- *The Emergency Program Act*
- *The Employee Investment Act*
- *The Employee Investment Act (2002)*
- *The Gaming Control Act*
- *The Land Title Act*
- *The Local Government Act*
- *The Municipalities Enabling and Validating Act (No. 3), S.B.C. 2001, c. 4*
- *The Motion Picture Act*
- *The Vancouver Chart*

The Real Estate Development Marketing Act, S.B.C: 2004, c. 41 (Bill 42), repeals and replaces Part 2 of *The Real Estate Act* regarding real estate development. It allows marketing of the property at an earlier stage in the development. It allows for less complex disclosure statements and allows developers to use the purchaser's deposit monies for construction. It eliminates prospectuses; creates new restrictions on the marketing of development to protect the purchaser's title; allows purchasers to receive disclosure, giving them seven days to rescind their purchase agreements; provides for liability for misrepresentation by developers; and specifies search in exemptions from this Act. Finally, it increases the superintendent's powers for enforcement of this Act.

The Real Estate Services Act: S.B.C.: 2004, c. 42 (Bill 41), repeals and replaces *The Real Estate Act* and *The Home Owner Protection Act*, 2001. This Act also grants power to the Real Estate Counsel of B.C. to regulate the licensing and discipline of real estate agents. It creates a special compensation fund for those who suffer losses as a result of the wrongful or criminal acts of real estate agents. It also requires the strata manager to be licensed.

The Miscellaneous Statutes Amendment Act (No. 3), 2004, S.B.C.: 2004, c. 67 (Bill 74), amends the following Acts:

- *The Environmental Management Act*
- *The Gaming Control Act*
- *The Personal Information Protection Act*

The Social Service Tax Amendment Act (No. 2), 2004: S.B.C.: 2004, c. 76 (Bill 76), amends *The Social Service Act* to reduce the provincial sales tax from 7.5% to 7%.

MANITOBA

There have been two substantial changes in legislation:

The Budget Implementation and Tax Statutes Amendment Act, 2004, experienced three significant changes. First, the penalty for not paying outstanding taxes has been doubled from 5% of the total amount outstanding to 10%. Second, § 30 now provides that the person to whom a request has been made to provide information on a corporation is now liable for failing to give such information, rather than the corporation itself, and must pay the fine. Third, the minister may now issue a certificate as to the amount of the debt and file it in the court of the Queen's Bench. As a result of the filing of the certificate, the debt is now enforceable as a judgment of the court in favour of the government.

The Non-Smokers Health Protection Act (various acts amended), S.M.: 2004, has experienced three main changes.

- Proprietors are now liable to ensure that there is no smoking where smoking is prohibited;
- Proprietors are now required to ensure that there are no ashtray or similar devises where smoking is prohibited; and
- There is a fine for breach of the first of the above listed changes to the Act.

NEW BRUNSWICK

On December 1, 2004, an *Act Respecting Sunday Shopping* came into force. This Act allows municipalities to determine whether retail businesses can open on Sundays. Previously in New Brunswick, Sunday shopping was only permitted during what was known as "The Christmas Shopping Season." Otherwise, in order to be open on Sunday, a retailer had to apply to a Statutory Board for an exemption. As the result of the new law, each municipality can create its own by-laws regarding Sunday shopping—whether to allow it, prohibit or limit it. The only province-wide limitation remaining is that stores cannot open on statutory holidays throughout the year. Should a municipality decide not to legislate specific by-laws under its jurisdiction, stores will remain subject to the existing Sunday shopping laws.

The *Act Respecting Sunday Shopping* also amends the *Municipalities Act*. It allows smaller communities known as "Local Service Districts ("LSD")" that wish to have Sunday shopping within their boundaries to petition the minister to call for a public meeting where they can decide whether to allow Sunday shopping. The premise of these changes is that the government recognizes that the issues surrounding Sunday shopping are local and should be decided at that level. The government also recognizes that these changes removed the red tape from the process and municipalities no longer have to apply for exemptions to allow Sunday shopping.

On October 1, 2004, the *Smoke Free Places Act* replaces all existing municipal smoking by-laws and prohibits smoking in all enclosed public places and workplaces. This restriction includes such places as outdoor bus or taxi shelters and outdoor eating or drinking areas. An enclosed public place would also be considered a patio located outside of the structure where food or drinks are served or entertainment offered and more than 70% of its area is enclosed by walls, a roof or a combination of the two. Owners cannot designate smoking areas in enclosed public places. It is the owner's and employer's obligation to ensure that no person smokes in the prohibited areas. Owners and managers must also ensure that signs are placed at specific locations to inform the clientele of the smoking ban within the building. Failure to comply with this new legislation could result in fines between $240 and $2,620.

NEWFOUNDLAND

The first issue concerns smoking. While Newfoundland, until now, has had a limited smoking ban, legislation is expected in the near future for an absolute ban on smoking. Despite significant opposition from bar owners, the province is most likely to proceed with the new legislation.

The second issue concerns the assessment of business tax to the landowner. As a result, more owners will not only be primarily responsible for the realty tax, but will also become responsible for an equivalent amount of business tax. Under most circumstances, the cost will be passed on to the tenant, but the landlord's bad debt exposure is increased.

NOVA SCOTIA

The following developments have taken place, regarding Sunday shopping laws in the province of Nova Scotia, where Sunday shopping is governed by the *Retail Business Uniform Closing Day Act*. All retailers must remain closed on Sunday unless they fall within the exemptions listed within the Act. Such exemptions include drug stores, restaurants, cinemas, candy stores, canteens or fruit stands, flea markets, fish markets, laundromats, pool halls, video stores, book stores, magazine and newspaper stores, antique stores, art galleries, used clothing stores, handcraft and souvenir stores selling primarily to tourists, nursery or gardening supply stores, Christmas tree lots, and food stores with no more than 4,000 square feet of retail sales area.

Recently, two events occurred that could change Sunday shopping laws in Nova Scotia: First, in 2003, the Nova Scotia government experimented by allowing stores to remain open on Sundays for the six (6) Sundays preceding the Christmas holiday. Second, on October 16, 2004, there was a plebiscite, which asked two questions: (i) Should all retailers be permitted to open on Sundays? (2) If Sunday shopping is approved for all retailers, should it be limited to the six Sundays preceding Christmas?

Regarding the first question, approximately 55% of voters in Nova Scotia were opposed to Sunday shopping despite the majority of Haligonians having voted in favour of Sunday shopping. Regarding the second question, approximately 55% of voters would have been in favour of limiting Sunday shopping to the six Sundays before Christmas. As a result of this plebiscite, the restrictions imposed by the Act will remain in place, leaving Nova Scotia as the only province with a year-round ban on Sunday shopping for most retailers.

ONTARIO

The following recent changes have taken place in Ontario's legislation:

Bill 18 —Accessibility for Ontarians With Difficulties Act, 2004—The purpose of this bill is to develop, implement and enforce accessibility standards for Ontarians with disabilities with respect to goods, services, facilities, occupancy of accommodations, employment, buildings, structures and premises on or before January 1, 2025.

Bill 100 —Electricity Restructuring Act, 2004—In waiting for its third reading, the purpose of Bill 100 is to restructure Ontario's electricity sector, promote the expansion of electricity supply and capacity, facilitate load management and demand management, encourage electricity conservation and efficient use of electricity, and regulate prices in parts of the electricity sector.

Bill 133 —Environment Enforcement Statute Law Amendment Act, 2004—Introduced by way of first reading on October 27 *2004,* this bill amends the Environmental Protection Act and the Water Resources Act. Dealing with environmental penalties, a person upon whom an environmental penalty has been imposed can also be prosecuted for an offence in respect of the same contravention. The bill also revises penalties imposed by the courts when a person is convicted of an offence. Finally, the bill expands the duties of directors and officers so that they must take reasonable care to prevent the corporation from contravening any provisions of the legislation.

Bill 80 —The Gasoline Consumer Protection Act, 2004—Having experienced the second reading and been referred to the Standing Committee on Justice Policy, this bill requires every gasoline retailer to advertise a change in the price of gasoline at the retailer's gas station, at least 72 hours before changing the price. This bill also requires retailers to indicate on their price signs the distinction between the taxes and the cost of the gas. Finally, it requires all gasoline retailers to indicate their affiliation with major gasoline retailers on signs and on their receipts.

Bill 128 —The Law Enforcement and Forfeited Property Management Statute Law Amendment Act, 2004—This bill increases enforcement powers and penalties for building electrical and fire safety offences. It also expands the Crown's powers to deal with property that is forfeited to it as a result of unlawful activities.

Bill 96 —The Liquor License Amendment Act, 2004—This bill proposes a definition of "supply" to make it clear that the word includes cases where a licensee permits the consumption of wine on licensed premises, which a patron has brought onto the premises in accordance with the regulations for the patrons' consumption. This bill also gives the registrar the power to issue immediate interim suspensions of licences in the public's interest. It amends §§ 34 and 34.1 of the Act to prohibit persons, who have been required to leave licenced premises by a police officer, from remaining on the premises and from returning to the premises until the day after they left, unless authorized to do so by a police officer. Finally, it doubles the minimum fine for offences related to liquor and persons under 19 years of age.

QUEBEC

Municipal Reorganizations in Quebec —The Merger Process

On June 20, 2004, referendums were held in several municipalities to determine if they wanted to de-merge according to *The Act Respecting the Consultation of Citizens* with respect to territorial reorganization of certain municipalities. As a result of these referendums, the National Assembly passed an act respecting the exercise of certain municipal powers in certain urban agglomerations (*Bill 75*), allowing the formal reconstitution of 31 de-merged municipalities.

For a complete overview, the reader can consult the Web site of the Minister of Municipal Affairs, Sports and Recreation, at www.mamsl@gouv.qc.ca.

Act to Amend Various Legislative Provisions Concerning Municipal Affairs

The tax and surtax on non-residential immovables were both abolished as of January 2005. Municipalities that chose not to restrict themselves to the single rate general realty tax must now adopt stratified mill rates in order to impose the surcharge on non-residential properties and service to vacant lands.

New Fiscal Pact Between the Government and the Municipalities

On December 9, 2004, the Department of Finance and of Municipal Affairs tabled a joint document for discussion on the renewal of the five-year municipal government fiscal pact and on decentralization.

Extended business Hours in Quebec Shopping Centres

Since last August, numerous shopping centres have announced their intention to extend their opening hours to the maximum authorized by *The Act Respecting Hours and Days of Admission to Commercial Establishments*.

Opponents of the shopping hour extension sought governmental intervention, arguing that such an extension is sterile, as it does not increase the consumer shopping budget, and, therefore, the merchants' sales, while at the same time increasing costs for store operators. It was also argued that the trend would create an obstacle for employees to successfully balance their work and family obligations.

After some debate, on October 29, 2004, the government announced that it did not intend to change the law.

SASKATCHEWAN

There are three significant changes of particular interest in legislation:

1. Under *The Tobacco Control Amendment Act*, 2004, S.S. 2004, c. 51. Under the new § 23, which came into effect on June 17, 2004, a successor retailer is prohibited from keeping or furnishing tobacco or tobacco-related products at the premises where the offence took place, if a retailer is convicted of a second or subsequent offence pursuant to sub-section 20(1).

2. Bill 51 —The Limitations Act, 2005 —Bill 51 of *The Limitations Act* will come into effect on May 1, 2005. This Act modernizes the limitation periods in Saskatchewan by providing for a basic limitation period of two years running from discovery of cause of action, with an ultimate limitation period of 15 years.

3. On October 8, 2004, *The Gas Inspection Act* was amended:

§ 35.1 created specific prohibitions, specifically preventing anybody from interfering or misleading an inspector or tampering with any gas equipment in the course of the performance of the inspector's duties.

§ 35.2 of the same Act allows for penalties if the inspector believes that the person commenced gas installation work without a permit.

§ 36 was also altered to increase the maximum fine from $ 1,000 to $ 10,000, and to create liability for directors, officers or agents of a corporation.

§ 36 was modified to provide for vicarious liability.

§ 37(a) was amended to change the limitation period from three to two years.

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