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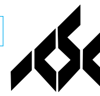

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Shopping Center Legal Update

The legal journal of the shopping center industry

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Wal-Mart: Turlock-ed Out

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It is estimated that approximately 20 cities and counties in northern California, including San Francisco (the city and the county are the same), Oakland and Alameda County, in which Oakland is located, have passed ordinances seeking to limit or block discount supercenters by restricting the amount of floor area permitted in a retailer's building. Some legal scholars view these size-cap ordinances as a valid exercise of the power of local government to regulate economic matters, and point to U.S. Supreme Court cases and lower court rulings that uphold the decisions of local government regarding such matters. Others argue that the size-cap ordinances discriminate against out-of-state businesses and, therefore, violate the equal protection, commerce and due process clauses of the U.S. Constitution.

This article examines recent state and federal legal challenges to a size-cap ordinance in the northern California city of Turlock, located in Stanislaus County, which is approximately 80 miles east of San Francisco in the rapidly growing Central Valley area.

BACKGROUND

In late 2002 and early 2003, Wal-Mart began the process for developing a Wal-Mart Supercenter in the City of Turlock (the "City"), and the City provided Wal-Mart with certain information regarding entitlements and estimated fees. Wal-Mart claimed that City officials initially encouraged Wal-Mart to submit an application, and Wal-Mart actually purchased the property in July 2003. However, the City subsequently advised Wal-Mart that a conditional use permit and an environmental impact report ("EIR") would be needed. The City disputed that it "encouraged" Wal-Mart, claiming that it was merely supplying information requested by Wal-Mart, much as it would do with any other retailer. The City did, however, concede that after lobbying efforts by union leaders and grocery-store representatives, it passed a zoning ordinance in November 2003 banning discount superstores that exceed 100,000 square feet (sf) of floor area and devote at least 5% of sales floor area to non-taxable items such as groceries.

WAL-MART'S STATE CLAIMS

A. Turlock Overstepped Its Power in Passing the Ordinance

In early 2004, Wal-Mart filed a petition for a writ of mandate and a complaint for declaratory relief in California state superior court, claiming that the City's approval of the ordinance (a) was an arbitrary, capricious and unlawful legislative act; (b) violated zoning laws; and (c) violated the California Environmental Quality Act ("CEQA"). In December 2004, the superior court denied the petition for a writ of mandate and the request for declaratory relief, finding that the ordinance was a proper

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exercise of the City's police power, even though it had some anti-competitive effect, and that the ordinance did not violate zoning laws. The superior court also found no CEQA violation. Wal-Mart appealed the superior court ruling; however, in a ruling published in April 2006, the California 5th District Court of Appeal (the "Court") upheld the ordinance. *Wal-Mart Stores Inc.* v. *City of Turlock,* 138 Cal. App. 4th 273.

Wal-Mart argued that the ordinance should be invalidated on the grounds that the City exceeded its police power in passing the ordinance. In particular, Wal-Mart claimed that the ordinance (1) was passed to single out Wal-Mart and to suppress economic competition; (2) was not reasonably related to the public welfare; (3) had effects outside the City; and (4) was not a reasonable accommodation of competing interests.

The Court disagreed with all of Wal-Mart's claims, finding that the City had acted within its power to control and organize development within its boundaries as a means of serving the general welfare. The Court determined that the ordinance was reasonably related to a legitimate policy choice of preferring neighborhood shopping centers equally dispersed throughout the City over big-box megastores. The Court also found that the ordinance served to prevent the collapse of existing grocery stores that anchor neighborhood shopping centers and the resulting deterioration—pointing to a recent example in the City where an Albertson's had closed and the remainder of the center suffered a decline in rents and lacked its former vitality. The Court added that the ordinance also served to prevent other significant changes in the community, including changes to employment, traffic patterns (such as citizens being required to drive farther for day-to-day consumer goods) and land use.

The Court also found that the ordinance did not single out Wal-Mart, because it was aimed at all stores over 100,000 sf. The Court stated that "while zoning ordinances may not legitimately be used to control economic competition, they may be used to address the urban/suburban decay that can be its effect." The Court stated that the fact that some competitors lobbied for the ordinance was not significant. Moreover, although Wal-Mart was the first to feel the impact of the ordinance, this did not demonstrate targeting. The Court went on to say that if an ordinance such as this did constitute targeting, cities would never be able to react to new situations.

With respect to effects outside the City, the Court simply found that Wal-Mart had failed to show that there would be any significant effects on residents of surrounding communities. Therefore, there was no need to address that claim further (other than with respect to CEQA, as discussed below). Nor did the Court address Wal-Mart's claim regarding reasonable accommodation of competing interests.

B. The Ordinance Violated CEQA

Wal-Mart further claimed that the ordinance violated CEQA. According to Wal-Mart, the City failed to study the environmental ramifications of banning megastores—which Wal-Mart claimed would have the effect of increasing pollution and traffic, as consumers would be forced to make multiple trips to various locations instead of making a single trip to a one-stop store. Wal-Mart cited a study conducted by its engineering, planning and environmental consultants, which concluded that a Wal-Mart Supercenter would generate significantly fewer vehicle trips than even a multi-tenant shopping center located on the same property with the same square footage as the planned Supercenter, thereby decreasing traffic congestion, limiting traffic growth, and decreasing air pollution.[1]

The Court disagreed with this argument on procedural grounds, finding that an in-depth CEQA review, triggered solely by the passing of the zoning ordinance and prior to any development, would be premature. The Court stated that the environmental concerns presented by Wal-Mart were overly speculative and would be addressed at the time any proposed stores petitioned the City for use permits. The Court found that the specific possibility of the development of a multi-tenant shopping center on the same property, while possible, was not reasonably foreseeable; therefore, Wal-Mart's predicted environmental impacts were tentative and not peculiar to the ordinance. The Court concluded that the enactment of the zoning ordinance amendment was not a "project" for purposes of CEQA, was consistent with the City's general plan and was adequately covered by the EIR for the general plan.

Wal-Mart further argued that the ordinance violated CEQA because the City failed to study the off-site environmental impacts. Wal-Mart claimed that by prohibiting superstores within Turlock, the ordinance would force such stores to be located beyond the Turlock city limits. Turlock consumers and employees would, therefore, be forced to travel much longer distances to shop and/or work at such stores. The Court dismissed this argument as well, again finding that Wal-Mart's argument was overly speculative and not reasonably foreseeable, as it was based on the assumption that Wal-Mart would in fact build a superstore in a neighboring community if blocked from entering Turlock. The Court added that off-site environmental impacts were sufficiently addressed in the EIR prepared for the Turlock General Plan, and the fact that the EIR did not address speculative off-site and cumulative impacts was of no consequence to the case.

WAL-MART'S FEDERAL CLAIMS

Wal-Mart also filed a suit in federal court, claiming, among other things, violations of due process rights, equal protection rights and the commerce clause, as well as violations of civil rights. In July 2006, a federal district court judge dismissed Wal-Mart's claim in an order granting the City's summary judgment motion. *Wal-Mart Stores, Inc.* v. *City of Turlock,* 2006 WL 1875446. Although the U.S. District Court for the Eastern District of California (the "District Court") agreed with Wal-Mart on

a number of procedural issues,[2] the District Court nonetheless held that there were no constitutional violations by the ordinance. In making its constitutional claims, Wal-Mart alleged collusion by the City with local supermarkets and local producers of goods. It also claimed that the ordinance interfered with interstate commerce, illegally discriminated against out-of-state entities and was vague.

The District Court held that there was no equal protection violation because the ordinance involved social and economic policy and did not target a suspect class or impinge on a fundamental right. Consequently, the ordinance only required a rational basis, which the District Court found existed. Among Wal-Mart's rejected arguments were that urban blight is not a legitimate state interest (the District Court stating that it definitely was)[3] and that the ordinance discriminated against foreign entities. (The District Court noted that the ordinance applied to all entities, foreign or domestic.) With respect to interstate commerce, the District Court noted (among other things) that a discriminatory purpose alone is not sufficient to invalidate a law, and the putative benefits of the ordinance far outweighed any burdens (but the District Court did not find any) that might be imposed on interstate commerce. With regard to Wal-Mart's due process/void-for-vagueness argument, the District Court noted that the ordinance could hardly be said to be vague when it explicitly forbade the type of store Wal-Mart wanted to construct.

Finally, regarding the claim of collusion, the District Court noted that an improper motive, by itself, does not affect constitutional review of legislation. Furthermore, since the ordinance was not discriminatory, based on a suspect or quasi-suspect classification, and was rationally related to legitimate state interests (preventing urban blight, traffic congestion and air pollution), it passed constitutional muster.

EPILOGUE

In July 2006, the California Supreme Court declined to hear Wal-Mart's appeal without comment, and Wal-Mart recently dropped its appeal to the federal case, explaining that the Turlock situation has been examined by a number of courts and that Wal-Mart has not prevailed. Although Wal-Mart does not agree with the decisions, it feels that there is nothing to be gained by an appeal. Further, Wal-Mart believes that these decisions, which are state precedent only for California, are narrowly based on facts specific to Turlock, and thus will be distinguishable elsewhere. However, many observers believe that, regardless of one's opinion on size-cap ordinances, these cases provide a template for other communities seeking to block discount superstores, such as that proposed by Wal-Mart, through zoning ordinances similar to that enacted by the City.

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[1] In the federal case discussed below, the District Court cited several studies in the ordinance's record indicating that Wal-Mart Supercenters increase more traffic than anticipated, and more traffic than discount clubs or discount stores.
[2] E.g., the District Court found that (i) the issue was ripe for challenge (it would have been "futile" to seek a variance, since the City could not, under the ordinance, allow the Supercenter), notwithstanding that (a) only a "facial" challenge, as opposed to an "as applied" challenge, was made by Wal-Mart, and (b) Wal-Mart had not applied for a variance; (ii) there was no requirement to exhaust state remedies (not applicable in federal court); (iii) there was no *res judicata* based on the City's decision (the "futility" exception excused any such failure); and (iv) Wal-Mart was not barred from bringing a claim based on the City's 90-day statute of limitations for denial of an application (inapplicable to commerce clause challenges under Title 42, Section 1983 of the U.S. Code).
[3] The District Court cited several studies in the record for the ordinance indicating that Wal-Mart Supercenters can have negative effects on existing businesses and may contribute to blight.

Letter of Credit Trumps Cap on Damages

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A landlord holding a letter of credit as a security deposit may avoid the bankruptcy court limitations on the amount it can recover from a bankrupt tenant if it does *not* file a proof of claim.

Landlords often think that failure to file a proof of claim in a tenant's bankruptcy proceeding may result in the loss of rights. Although that may happen in most instances, the opposite may happen if a letter of credit is held as a security deposit, according to the court in *In re Stonebridge Technologies, Inc.*, 430 F.3d 260 (5th Cir. 2005). The decision in this case was rendered on November 8, 2005, by the Fifth United States Circuit Court of Appeals, pursuant to an appeal from the United States District Court for the Northern Division of Texas, Dallas Division.

In *In re Stonebridge Technologies, Inc.*, EOP-Colonnade of Dallas, LP ("EOP"), leased office space to Stonebridge Technologies, Inc. ("Stonebridge"), on September 21, 2000 ("Lease"). The Lease provided that Stonebridge would furnish a security deposit in the form of a $1,430,065.74 letter of credit. The Bank of Oklahoma ("Bank"), which issued the letter of credit to EOP as beneficiary, required Stonebridge to pledge a $1,250,000 certificate of deposit to protect the Bank in the event the letter of credit were presented for payment.

Stonebridge filed a Voluntary Petition pursuant to Chapter 11 of the United States Bankruptcy Code ("Code") on September 6, 2001, and stated that it intended to reject the Lease effective sometime during the period of October 1 and October 23, 2001.

On October 30, 2001, EOP presented the letter of credit for payment and the Bank paid EOP the sum of $1,430,965.74. The bankruptcy court then entered an order rejecting the EOP Lease effective as of October 1, 2001, and awarding EOP pre-petition and post-petition administrative rent in the amount of $59,687.31. A proof of claim for actual damages resulting from rejection of the Lease was *never* filed by EOP.

Next, the Bank sought to lift the automatic stay so that it could liquidate the $1,250,000 certificate of deposit and reimburse itself in part for the payment made to EOP. The Trustee negotiated an arrangement whereby the Bank was allowed to keep the certificate of deposit in exchange for the Bank's assigning to him any claim of the Bank against EOP arising in connection with payment of the letter of credit.

The Trustee instituted an adversary proceeding against EOP. The bankruptcy court held that EOP was premature in presenting the letter of credit for payment, retained proceeds of the letter of credit in excess of that allowed by Section 502(b)(6) of the Code and made negligent misrepresentations regarding what was due.

The bankruptcy court also concluded that the letter of credit was subject to the cap in Section 502(b)(6) of the Code because it was a security deposit. It held that EOP breached the Lease by presenting the letter of credit before entry of the order rejecting the Lease and was negligent in representing to the Bank that the full amount of the letter of credit was due and owing.

The bankruptcy estate (as assignee of the Bank's claims) was awarded damages of (a) $180,065.40 for negligent misrepresentation, being the difference between the amount paid pursuant to the letter of credit and the amount of the certificate of deposit retained by the Bank; and (b) $2,267.23 for breach of lease, being the difference between the amount which EOP was entitled to collect pursuant to Section 502(b)(6) of the Code and the amount of the certificate of deposit retained by the Bank. The district court affirmed the bankruptcy court's decisions and EOP appealed.

The court addressed certain considerations relating to the general bankruptcy jurisdiction and the distinctions between "core" and "non-core" proceedings, and then analyzed the legal issues presented on appeal.

The claim against EOP for breach of the lease resulting from premature presentation of the letter of credit and retention of sums in excess for the amounts allowed by Section 502(b)(6) of the Code was a claim held directly by the Trustee for the bankruptcy estate. The claim for negligent misrepresentation by EOP regarding what was due and owing in connection with presentment of the letter of credit for payment and retention of proceeds thereof in excess of that allowed by Section 502(b)(6) of the Code was a claim assigned by the Bank to the Trustee. The Circuit Court of Appeals focused its legal analysis on the common issues presented by these separate claims. Was EOP (a) entitled to retain proceeds of the letter of credit in excess of the cap in Section 502(b)(6) of the Code; and was EOP (b) premature in presenting the letter of credit for payment and, therefore, in breach of the Lease?

Section 502 of the Code provides generally that claims are allowed, except in specific circumstances such as when an objection is made to the claim, in which event the bankruptcy court determines what, if anything, is owed. If the claim is that of a landlord for lease termination, it is limited to an amount equivalent to (a) the rent, measured from the earlier of the date of filing the petition in bankruptcy or termination of the lease, for the greater of: (i) one year; or (ii) 15%, not to exceed three years of the remaining lease term; plus (b) unpaid rent which accrued prior to that date. This provision of the Code is designed to compensate landlords for a relatively reasonable amount without allowing disproportionately large claims that would unfairly disadvantage other creditors.

The obligation to pay the beneficiary pursuant to a letter of credit is an independent obligation of the issuer, and not the third party procuring the letter of credit such as a tenant. Accordingly, the letter of credit and the proceeds thereof were deemed part of the bankruptcy estate.

The court noted that the limitation on recovery imposed by Section 502(b)(6) of the Code applies only to claims filed against the bankruptcy estate. The court then proceeded to overrule the decision of the bankruptcy court by holding that because EOP did *not* file a claim with the bankruptcy estate, the amount it could recover from the issuer of the letter of credit was *not* limited by Section 502(b)(6) of the Code. That disposed of the first clause.

Next, the court considered whether EOP was premature in presenting the letter of credit for payment. EOP argued that it was entitled to present the letter of credit for payment because (a) Stonebridge was in monetary default as a result of failing to pay pre-petition rent; (b) the Code did not prevent enforcement of the insolvency clause in the Lease to the extent it triggered obligations of third parties such as the issuer of the letter of credit; and (c) it was after the effective date for rejection of the Lease. It should be noted that it is often argued in the course of lease negotiations that the bankruptcy default provisions are unenforceable; this demonstrates that they may still be effective as to third parties.

The court held that EOP was justified in presenting the letter of credit for payment because Stonebridge was in monetary default under the Lease. The Lease provided that the failure to pay rent would constitute a monetary default only if notice were given and five days elapsed without payment. The court overruled the bankruptcy court by holding that this notice requirement was satisfied by the filing of a motion for payment of rent more than five days before the letter of credit was presented for payment

The damages sustained by a landlord when its lease is rejected in bankruptcy, without application of the limitations set forth in Section 502(b)(c) of the Code, are the difference between the market rental value of the premises for the remainder of the lease term, less the rent to have been paid under the Lease after the anticipated expenses of re-letting, both reduced to net present value. In this case, because the damages of EOP calculated in this manner exceeded the face amount of the letter of credit, EOP was entitled to retain all the proceeds of the letter of credit.

EOP was found *not* to have breached the Lease nor made negligent misrepresentations when it presented the letter of credit for payment. The court noted that the filing of a proof of claim serves no purpose if the creditor holds adequate security and does not intend to assert a claim against the estate in bankruptcy. The damages recovered by EOP pursuant to the letter of credit consisted of (a) rent through the date the Lease was terminated; (b) plus all future rent for the remainder of the lease term, had it not been terminated, discounted to net present value at prime rate; (c) less the fair rental value of the premises for the remainder of the Lease term, discounted in the same manner, after deducting the anticipated costs of re-letting.

As this case demonstrates, a landlord with a letter of credit may avoid the statutory limitation on what it can recover if it does not file a proof of claim. Although the decision in *In re Stonebridge Technologies, Inc.* was rendered by the Fifth United States Circuit Court of Appeals and establishes a legal precedent only in the states of Louisiana, Mississippi and Texas, it is indicative of how other bankruptcy courts throughout the nation may treat landlords with letters of credit who do not file proofs of claim. It is important that bankruptcy counsel for the landlord, which typically is not the attorney that interacts with the client on a day-to-day basis, be made aware early of the existence of any letter of credit held as a security deposit so that a coordinated strategy may be developed for presentation of the letter of credit for payment and any filing of a proof of claim in the tenant bankruptcy proceeding.

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Tenant Estoppel Certificates: Purposes and Interpretations

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The Purpose of Tenant Estoppel Certificates

By definition, an estoppel certificate is "[a] signed statement by a party (such as a tenant or mortgagee) certifying for another's benefit that certain facts are correct, as that a lease exists, that there are no defaults, and that rent is paid to a certain date. A party's delivery of this statement estops that party from later claiming a different state of facts." *Black's Law Dictionary,* 572 (7th Ed., 1999).

The prospective purchaser of a shopping center has a keen interest in obtaining estoppel certificates from as many tenants as possible because "[a]n estoppel certificate (also called an estoppel statement or estoppel letter) is a writing given by a lessee setting forth specific facts pertaining to the lessee-lessor relationship, with the intention that a third party (normally, the lender or a purchaser of the fee interest) rely on the statements." Alvin L. Arnold & Jeanne O'Neill, *Real Estate Leasing Practice Manual,* § 35:1 (West Online 2005). "The purpose of an estoppel statement is twofold: (1) to give a prospective purchaser or lender information about the lease and the leased premises and (2) to give assurance to the purchaser or lender that the lessee at a later date will not make claims that are inconsistent with the statements contained in the estoppel." *Id.*

Depending on the size of the shopping center at issue, a 100 percent response rate from tenants may not be feasible, but "a buyer should insist on estoppel certificates from all tenants whose tenancies are a key component of a property's cash flow." Stephen A. Cowan, *Negotiating the Sophisticated Real Estate Deal 2004: High Stakes Strategies in Uncertain Times: Strategic Analysis of Due Diligence Issues,* 39, 58 (*PLI Real Estate Law & Practice Course Handbook*, Series No. 2948, 2004). As part of its due diligence, a purchaser will rely upon tenant estoppel certificates in determining the offering price for the shopping center, and whether the price ultimately paid is reasonable, given the property's income-generating capacity.

Despite their widespread usage, there are relatively few reported decisions interpreting the effect of tenant estoppel certificates in landlord-tenant lease disputes.

Cases Interpreting Tenant Estoppel Certificates

Cases interpreting tenant estoppel certificates are largely driven by the facts of each dispute. Common to all of the disputes, however, is a determination that the shopping center purchaser (as well as a landlord) is entitled to rely upon the representations made by a tenant in an estoppel certificate.

Ohio

In *Mark-It Place Foods, Inc.* v. *New Plan Excel Realty Trust, Inc.,* 156 Ohio App.3d 65 (2004), New Plan purchased a shopping center after obtaining an estoppel certificate during its due diligence period. A dispute later arose about an exclusive use violation. All parties moved for summary judgment; on appeal, the Ohio Court of Appeals affirmed in part and reversed in part, and remanded the cause for further proceedings. The court of appeals noted that New Plan, as the purchaser of the shopping center, was entitled to rely upon a January 1993 estoppel letter (obtained during the course of its due diligence prior to purchasing the center). New Plan had introduced evidence of reliance on the representation made in the estoppel certificate. *Mark-It Place Foods,* 156 Ohio App.3d at 88 - 89, 91 and 94. On remand, the trial court was charged with determining whether New Plan's reliance was reasonable under the facts of the case.

In *Freshman* v. *Attaboy Manufacturers' Representatives, Inc.,* 92 AP-638, 1993 WL 20061 (Ohio App. Feb. 2, 1993), Attaboy entered into a triple net lease with the landlord's predecessor-in-interest in 1984. Attaboy was required to pay minimum rent on a monthly basis, along with real estate taxes and hazard insurance, and periodically execute and deliver estoppel certificates to the landlord. (The tenant acknowledged that the estoppel certificates might be relied upon by a prospective purchaser of the shopping center.) The original landlord agreed to construct a 12,000 square foot (sf) building for the tenant, and the tenant agreed to pre-pay certain rents. Although delivery of the completed building was scheduled for February 1984, it did not occur until April 1984; as a result, the tenant was entitled to rent abatement under the terms of the lease. In December 1986, Freshman purchased the shopping center. As part of the landlord's due diligence, the tenant executed an estoppel certificate which acknowledged that it had not received any rent concessions, and had not made any payments to the landlord as advanced or prepaid rent. When Attaboy subsequently vacated the property, Freshman's attempts to collect unpaid rent, property insurance and property taxes were unsuccessful, and litigation followed. The trial court found for Freshman, but awarded substantially less than what was sought in the complaint.

The court of appeals later opined that the trial court erroneously construed the tenant estoppel certificate executed by Attaboy, and reversed and remanded. Addressing the purpose of the estoppel certificate, the court of appeals noted that "this certificate estopped Attaboy from claiming any prepaid rent against plaintiff. There may have been some question of what the overpayments were for in 1986, but this particular estoppel certificate was sought for the protection of *plaintiff,* as is typi-

cally done in commercial lease transactions." *Freshman,* 1993 WL 20061 at *4 (emphasis added). The court of appeals also recognized that "[e]stoppel certificates are useful devices to preserve and enhance the marketability of commercial property." *Id.*

Similarly, in *Katz* v. *M.M.B. Co.,* No. 50579, 1986 WL 5298 (Ohio App. May 8, 1986), the landlord and the tenant entered into a five-year lease in 1978. In 1979, and again in 1981, the tenant executed estoppel letters in which it affirmatively stated that it had no claims or set-offs with respect to rent paid under the lease. In 1984, the tenant sued the landlord for breach of contract, claiming it had paid annual rent in excess of that required by the lease. The trial court held that the landlord had overcharged the tenant. On appeal, the landlord contended that the trial court erroneously failed to apply the doctrines of waiver or estoppel to bar the tenant's action. The Ohio Court of Appeals noted that the landlord's rent bills were itemized to reflect the amounts paid in rent, operating expenses and electricity, and concluded that the tenant should have known by the time the estoppel letters were executed in 1979 and 1981 that he was being overcharged. The court of appeals went on to hold "that when the tenant signed the letters waiving his claims upon the lease, he was on constructive notice that its terms were being violated." Katz, 1986 WL 5298 at *3. The court of appeals concluded that the "letters estop the tenant from claiming he has been overcharged." *Id.* Somewhat inconsistent with that statement however, the court of appeals affirmed in part, reversed in part, and remanded the case to the trial court to determine the extent of the landlord's liability for overcharges *after* the 1981 estoppel letter, finding that the tenant had waived only that portion of overcharged rent preceding the 1981 estoppel letter, and was, therefore, entitled to a refund for all overcharged rent thereafter.

New York

In *SRM Card Shop, Inc.* v. *1740 Broadway Associates, L.P.,* 769 N.Y.S. 2d 483 (2003), the subtenant plaintiff took possession of retail sales space and adjacent storage space under a 1988 sublease with Hallmark. The original landlord then sold the building to the defendant in 1990. In 1996, the subtenant agreed with the landlord's agent to exchange the adjacent storage space for noncontiguous space in the building's basement, and the agent agreed to waive a December 1998 rent increase. Although Hallmark (as the sublessor) was not advised in advance of the proposed storage space exchange, a Hallmark representative was notified of the exchange the day it occurred and did not object. The lease was never modified in writing, and the original storage space was rented to another tenant. In 1997 (after the 1996 space exchange and before the originally scheduled 1998 rent increase), Hallmark and the subtenant plaintiff executed an estoppel certificate for the landlord, which stated (among other things) that there were no offsets, abatements, or defenses against fixed or minimum rent, escalation rent or additional rent payable under the lease. In December 1998, the landlord implemented the scheduled rent increase, and the plaintiff refused to pay, citing the 1996 oral agreement. The subtenant brought a declaratory action against the landlord for reformation of the lease, and the landlord commenced a separate action for nonpayment of rent. After the cases were consolidated, the trial court granted summary judgment in favor of the subtenant. The trial court found that Hallmark had been actually partially evicted, and neither Hallmark nor the subtenant was obligated to pay the increased rent until possession of the original storage space was restored. On appeal, the landlord argued that Hallmark had acquiesced to the storage space substitution, and the estoppel certificate executed by Hallmark and the subtenant barred the partial actual eviction defense. The appellate division of the supreme court agreed, reversed and granted summary judgment for the landlord.

Pennsylvania

In *Liberty Property Trust* v. *Day-Timers, Inc.,* 815 A.2d 1045 (2003), Day-Timers entered into a 1988 lease with Liberty's predecessor-in-interest. The lease was amended in 1991 by way of an addendum, and provided for a flat rental charge through June 1, 1996, with annual increases thereafter based upon percentage increases in the Consumer Price Index (CPI). Prior to the June 1996 increase, Day-Timers was notified by the original landlord that the rent would increase by only 8% as opposed to 15%.

The following month, the original landlord circulated a second addendum to the lease, which proposed a further modification to the annual CPI adjustment to Day-Timers' rent. The second addendum was never executed, but rent was apparently calculated by the original landlord and paid by Day-Timers as if it were in effect. Liberty acquired the property from the original landlord in 1997. As part of the sale, Day-Timers executed a tenant estoppel certificate that identified the 1988 lease and the 1991 addendum as the operative lease documents, but made no reference to the proposed and unexecuted second addendum. After Liberty acquired the property, it charged Day-Timers rent calculated without regard to the unexecuted second addendum. Day-Timers refused to pay, and Liberty sued for breach of the lease and declaratory relief. The trial court, finding that the unexecuted second addendum was an enforceable oral modification of the lease, entered judgment in favor of Day-Timers, and Liberty appealed. On appeal, the Pennsylvania Superior Court vacated the trial court's judgment and remanded the case, noting that "no reference was made to the modification of the lease which is at the heart of this dispute." *Liberty Property,* 815 A.2d at 1051. Focusing on the central issue of the case, the superior court found that "Day-Timers made an affirmation [sic] representation in the certificate that there were *no* oral modifications of the lease, precisely the opposite of what it now claims to be the case." *Id.* (emphasis in original). Determining that the trial court abused its discretion, the superior court opined that "the whole purpose of tenant estoppel certificates is to avoid the very situation that resulted in this lawsuit." *Liberty Property,* 815 A.2d at 1052.

California

California courts have afforded estoppel certificates even greater weight than courts in other jurisdictions. In *Plaza Freeway Limited Partnership* v. *First Mountain Bank,* 81 Cal.App.4th 616 (2000), the landlord plaintiff and the defendant tenant were successors-in-interest to the original landlord and tenant under a 25-year commercial real estate lease. Prior to the time the plaintiff purchased the real property, the defendant signed and delivered an estoppel certificate, which affirmatively represented the lease expiration date to be October 31, 1998. When the defendant did not timely exercise an option to renew the lease and did not vacate the premises, the landlord commenced an unlawful detainer/eviction action against the tenant. Notwithstanding the tenant's estoppel certificate, the trial court concluded that the actual expiration date of the initial lease term was some eight months later. The court of appeal reversed, finding that the estoppel certificate was a "written instrument" for evidentiary purposes under California law, and the tenant was estopped from contradicting the October 31, 1998, date in the estoppel certificate. The *Plaza Freeway* Court concluded that "estoppel certificates are almost always used in commercial real estate transactions. They inform lenders and buyers of commercial property of the tenant's understanding of the lease agreement. Lenders and buyers rely upon the certificates in finalizing loans and purchases. Thus, application of [California Evidence Code] Section 622[1] 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." *Plaza Freeway,* 81 Cal.App.4th at 628 B 629.

The court of appeal in California further emphasized the breadth of issues affected by a tenant's estoppel certificate in *Miner* v. *Tustin Avenue Investors LLC,* 116 Cal.App.4th 264, 273 (2004) when it opined:

> Estoppel certificates are equally critical to landlords because they affect their ability to sell commercial real property and to secure financing. Estoppel certificates inform prospective buyers and lenders of the lessees' understanding of the lease agreement. By providing independent verification of the presence or absence of any side deals, estoppel certificates prevent unwelcome post-transaction surprises that might adversely effect [sic] the building's income stream, such as: Has the tenant pre-paid any rent? Does the tenant have any known or suspected claims for lease violations? What is the tenant's understanding of provisions of the lease? Are there any modifications or amendments? Did the tenant pay a security deposit? Has the landlord made all requested improvements? Are there any subleases or assignments? Is the tenant solvent?

Practical Considerations

Not all leases carry a requirement that the tenant provide estoppel certificates to the shopping center landlord. Where such a requirement does exist, factors such as the prospective purchaser's objective (long-term hold or short-term flip), the size of the shopping center, the number of tenants and the lender involved in a purchase may dictate the time devoted to obtaining and reviewing tenant estoppel certificates. With appropriate consideration given to the economics of transactions, counsel for shopping center landlords and prospective purchasers will best serve their clients' interests by obtaining as many tenant estoppel certificates as possible and carefully examining them for accuracy during the appropriate due diligence period. Thus, the possibility of later litigation over material lease terms will be minimized.

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[1] Cal. Evid. Code § 622 provides: "The facts recited in a written instrument are conclusively presumed to be true as between the parties thereto or their successors in interest; but this rule does not apply to the recital of a consideration."

Fashion Valley Mall, LLC v. National Labor Relations Board

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The National Labor Relations Board ("NLRB") asserts that the owner of Fashion Valley Mall in San Diego, California (the "Owner"), may not maintain or enforce a rule that prevents protestors on mall property from asking mall patrons not to purchase goods from mall tenants. In support of its position, the NLRB relies on provisions of the National Labor Relations Act[1] and a questionable interpretation of California law. For eight years, the NLRB has persisted in litigation against the Owner, finally reaching a panel of the United States Court of Appeals for the District of Columbia Circuit. The Court of Appeals, finding that the Owner had violated the Act only if it did not have a right under California law to enforce its rule,[2] has certified to the Supreme Court of California the following question: "Under California law may Fashion Valley maintain and enforce against the Union its rule 5.6.2?"[3]

A brief review of the facts of the case will aid in the discussion below. On October 3, 1998, the Owner received a call from the president of Graphic Communications International Union, Local 432M, AFL-CIO (the "Union") giving notice that the Union intended to conduct a protest at the mall on the following day. Management informed the caller that while expressive speech was permitted at the mall, all demonstrators were required to obtain a permit from the management office and to abide by the mall's rules. The Union refused to make application for a permit, and on the following day, the Union stationed about 30 members and supporters[4]—five to seven at each entrance—outside the mall's Robinsons-May department store.[5] The protestors talked with, and distributed flyers to, Robinsons-May shoppers and employees. The text of the flyer read as follows:

The News You Will NEVER read in The San Diego
UNION-TRIBUNE

Dear Customer of Robinsons-May,

- **The Union-Tribune threatens to discontinue our pension;**
- **Pressroom workers are forced to pay excessive health insurance costs, ten times higher than other employees;**
- **The Union-Tribune has been guilty of numerous Labor Board charges;**
- **Pressroom workers have had no pay raise in nearly seven years.**

To the employees of Robinsons-May,

Our dispute is with the San Diego Union-Tribune.

We are not asking you to cease working for your employer.

How you can help

If you feel that employers should treat employees fairly,

Call Gene Bell, CEO at the Union Tribune

* * *

The Union-Tribune makes record profits each year and they should be willing to share a small portion of them with the people who actually do their labor to put out the paper.

Robinsons-May advertises with the Union-Tribune.[6]

A quarter-hour after the protestors arrived, the mall's general manager approached the demonstration leader and told him that the Union must either apply for and obtain a permit for the protest or leave the mall. The general manager also gave the Union representative a notice of trespass and copies of the mall's application and rules. The representative refused the application and rules, and the protesters left the mall peaceably without applying for a permit.[7]

Nearly two weeks after the aborted protest, the Union filed an unfair labor practices charge against the Owner and ultimately refused two invitations from the Owner to structure a protest that would comply with the mall's rules.[8] The NLRB prosecuted the Union's claim in front of an administrative law judge and won a ruling that the Owner had violated the Union's rights under § 8(a)(1) of the Act.[9] The Board affirmed and ordered the Owner to rescind its Rule 5.6.2; however, in its order, the Board relied upon an interpretation of California law that remains in question. The Board held that Rule 5.6.2 was a "content restriction" rather than a "time, place and manner restriction," and stated that a content restriction is not permissible in shopping centers under California law.[10] The Owner took an appeal to the Court of Appeals, and the NLRB cross-petitioned for enforcement of its order.

The purpose of a shopping center is to offer goods and services for sale to the members of the public. Many modern shopping centers—especially lifestyle centers—undeniably offer activities and entertainment without charge; even in those circumstances, however, the underlying goal is to attract shoppers to the shopping center. At first blush, it might seem appropriate to conclude that since shopping centers are private property, owners would have a right to bar any speech on that property. That is not the case. Shopping center owners in California do not have an absolute right to bar exercises of free speech on their property[11] However, under *Waremart,* a union's speech in a shopping center is entitled only to the same protections as any other expressive speech.[12] The question, then, is not as narrow as whether the Owner may maintain and enforce Rule 5.6.2 against the Union. The question really is whether the Owner may maintain and enforce Rule 5.6.2 at all. That is a question of first impression under California law, but the Owner seems to have the better argument.

In *Los Angeles Alliance for Survival* v. *City of Los Angeles,*[13] the California Supreme Court examined whether the City's ordinance barring certain forms of solicitation for money violated the California Constitution. Although *Alliance for Survival* involved activities on public properties, its examination of "content" versus "time, place and manner" analysis is instructive in the Fashion Valley context.

As in *Fashion Valley,* the *Alliance for Survival* Court was responding to a California constitutional law question from a Federal court. As reformulated by the *Alliance for Survival* Court, the question was, "[w]hat is the proper standard under article I, section 2(a) of the California Constitution for analyzing the constitutionality of ordinances governing solicitation, such as Los Angeles Ordinance No. 171644?"[14] Ordinance No. 171644 barred solicitation in public places "with the purpose of obtaining an immediate donation of money" either with or without the purchase of goods or services, and it also barred the solicitation of money within specified distances from banks and ATMs and in certain other public places.[15] The *Alliance for Survival* Court began by acknowledging that the ordinance unquestionably implicated free speech, but noted that speech may be regulated under California law if the regulation applies to the time, place or manner of the conduct rather than to the content of the conduct.[16] The court went on to say that legislation governing the time, place and manner of speech but not the content of speech will be upheld if it is narrowly tailored, if it serves a significant government interest and if it leaves other ample means of communication available.[17]

Regulation of speech is content-neutral if the regulation is "justified without reference to the content of the regulated speech."[18] The *Alliance for Survival* Court engaged in a thorough analysis of the three United States Supreme Court cases that had examined content neutrality with respect to solicitation bans, noting that in all three cases, the Supreme Court had let the ordinances stand.[19] The court concluded that the common thread of *Lee, Kokinda* and *Heffron* was that although the regulations affected some types of speech without affecting others, the regulations were content-neutral and permissible because the regulations targeted the "inherently intrusive and potentially coercive" nature of a kind of speech rather than the actual content of the speech.[20] Applying *Lee, Kokinda* and *Heffron,* the court in *Alliance for Survival* concluded that Ordinance No. 171644 was constitutionally permissible regulation of speech that sought immediate exchange of funds or solicitation before certain captive audiences because it addressed the effect of speech rather than its content.[21]

Although *Fashion Valley* involves private property, *Alliance for Survival* is instructive on the analysis that the California Supreme Court should undertake. The ordinance in *Alliance for Survival* itself was not limited to public property. The restrictions in the ordinance applied to several types of private property, including parking garages and dining areas. It is unreasonable to suggest that a private property owner—even an owner of a shopping center—must withstand a higher level of scrutiny with respect to its own rules than the level of scrutiny applied to public property through an ordinance. The effect of asking patrons not to shop in a particular store is similar to the effect of solicitation in the areas in question in *Alliance for Survival.* Where the court in *Alliance for Survival* focused on the disruptive and coercive nature of solicitation, the California Supreme Court can reasonably conclude that many shoppers will be unwilling to cross a picket line to shop in a particular department store, with the result that the very reason for the shopping center's existence—the sale of goods and services—is jeopardized. Moreover, Rule 5.6.2 did not target any particular individual or group. Rather, it barred everyone from encouraging a boycott of mall tenants, regardless of the speaker's viewpoint.

The Owner's position here is bolstered by its analysis of *Clark* v. *Burleigh.*[22] In *Burleigh,* the California Supreme Court examined the United States Supreme Court's division of public property into three *fora*: (i) the traditional public forum, like public streets and parks, where expressive speech is anticipated as a matter of course and laws regulating speech are subject to strict scrutiny; (ii) the designated public forum, where expressive speech might not normally be anticipated, but because the government has opened the venue to expressive speech, laws regulating that speech are again subject to strict scrutiny; and (iii) all other public space, where laws regulating speech must survive only a reasonableness analysis so long as the regulation is not intended to squelch speech based upon disagreement with its content.[23] Both the administrative law judge and the NLRB failed to address the Owner's forum analysis.[24] Under *Burleigh,* public property must be categorized as one of the three *fora* before the analysis of the speech proceeds.

A shopping center is not, of course, public property and, therefore, is not directly susceptible to a public forum analysis. The Owner argues that if a shopping center were public property, it would fall into the non-public forum category; however, the Owner also asserts that an even lower standard applies to shopping centers than applies to a non-public forum.[25] That position finds support in *In re Hoffman.*[26]

In *Hoffman,* the site of the protest was a train station. The station was owned by three railroads, and, in addition to the train service, the station housed a restaurant, a bar, a snack bar and a newsstand.[27] The activity management sought to pro-

hibit was the distribution of leaflets opposing the war in Viet Nam.[28] The court concluded that that activity could not be prohibited, since it did not interfere with the normal use of the station; however, the court went on to say: "[had] petitioners in any way interfered with the conduct of the railroad business, they could legitimately have been asked to leave."[29]

Note the similarity to *Alliance for Survival.* In both cases, the California Supreme Court has already sanctioned the kinds of restrictions sought in *Fashion Valley,* i.e., to regulate speech that was "inherently intrusive and potentially coercive." If the Union's leafleting had been permitted to continue, then sales at Robinsons-May—at least for that day—might very well have been affected. That would have been a clear interference with the purpose of the mall; therefore, the restriction should be valid.

In the end, *Alliance for Survival, Burleigh* and *Hoffman* all support the Owner's position in *Fashion Valley.* Taken together, they provide the California Supreme Court with ample authority in support of the proposition that a shopping center owner may maintain and enforce reasonable restrictions on speech that is disruptive to the operation of its private property.

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[1]National Labor Relations Act, 29 U.S.C. §§ 151-169 [hereinafter, the "Act."]. NLRB relies on the following text in the Act: "It shall be an unfair labor practice for an employer (1) to interfere with, restrain or coerce employees in the exercise of the rights guaranteed in Section 157 of this title . . . ." *Id.* § 158(a)(1). The Owner does not dispute that it is an employer within the meaning of the Act. *See Fashion Valley Mall, LLC* v. *National Labor Relations Board,* 451 F.3d 241, 244 n.* (D.C. Cir. 2006).
[2]*See Fashion Valley,* 451 F.3d at 244 [citing *Waremart Foods* v. *NLRB*, 354 F.3d 870, 872 (D.C. Cir. 2004)].
[3]*Fashion Valley*, 451 F.3d 241, 246. The Owner's Rule 5.6.2 prohibited protesters from "urging, or encouraging in any manner, customers not to purchase the merchandise or services offered by one or more of the stores or merchants in the shopping center." [Corrected] Brief for Petitioner Fashion Valley Mall, LLC at 9 (June 17, 2005) [hereinafter "Petitioner's Brief"].
[4]*See Fashion Valley,* 451 F.3d at 242.
[5]*See* Petitioner's Brief at 9-10.
[6]*Id.* at 10-11 (emphasis and punctuation from the original; telephone number omitted). The combination of the written statement that Robinsons-May advertised in the Union-Tribune with leafleting directly in front of all the store's entrances (and only at that store's entrances rather than elsewhere in the mall) seems to have been designed to discourage shopping in that store—at least for that day. It also points out an oddity in the Petitioner's Brief. In what appears to have been an alternative argument, the Petitioner's Brief says that had the Union applied for a permit; the permit would have been granted because on its face the handbill did "not request a consumer boycott of Robinsons-May." *Id.* at 54. The question ultimately before the Court of Appeals is whether the Owner had a right to maintain and enforce Rule 5.6.2 rather than whether the Union's actions amounted to a violation of the Rule.
[7]*See Id.* at 11-12.
[8]*See Id.* at 13. By the time the Owner issued its second invitation, it had dropped Rule 5.6.2. Despite the rescission of the rule, the case is not moot, because the administrative law judge and the NLRB ordered the Owner to post a notice at the mall stating that it had violated Federal labor law and setting out a series of commitments with respect to labor organizers. *See Equitable Life Assurance Soc. of the U.S. & ITC Fashion Valley Corp. and Graphic Comm. Int'l Union, Local 432M,* 343 NLRB No. 57, at 4-5 (2004).
[9]*See Fashion Valley,* 451 F.3d at 243.
[10]*See Equitable Life,* 343 NLRB No. 57, at 3 (2004).
[11]*See Robins* v. *Pruneyard Shopping Ctr.,* 23 Cal. 3d 899, 592 P.2d 341 (1979) (finding "sections 2 and 3 of Article I of the California Constitution protect speech and petitioning, reasonably exercised, in shopping centers even when the centers are privately owned").
[12]*See Waremart,* 354 F.3d 875.
[13]22 Cal 4th 352, 993 P.2d 334 (2000).
[14]*Id.* at 360, 993 P.2d at 337.
[15]*Id.* at 363-64, 993 P.2d at 339-40. The court specifically pointed to the provisions of the ordinance regulating speech by those "who '[s]olicit, ask or beg' by 'using the spoken, written, or printed word or bodily gestures, signs or other means *with the purpose of obtaining an immediate donation of money* or other thing of value.'" *Id.* (emphasis in the original). The court also noted bans on: All solicitation in certain defined places (with specified exceptions): within 15 feet of banks and automated teller machines; directed at occupied motor vehicles located in a public space; in parking lots or structures after dark; in public transportation vehicles and within 10 feet of such vehicle stops; and in any outdoor or indoor dining area of a restaurant. *Id.*
[16]*See Id.* at 364, 993 P.2d at 340.
[17]*See Id.* at 364-65, 993 P.2d at 340-41 [citing *Savage* v. *Trammell Crow Co.,* 223 Cal. App. 3d 1562, 1574-74 (1990)].
[18]*Alliance for Survival,* 22 Cal. 4th at 367, 993 P.2d at 342-343 [citing *Clark* v. *Community for Creative Non-Violence,* 468 U.S. 288, 293 (1984)].
[19]*See Alliance for Survival,* 22 Cal. 4th at 368-73, 993 P.2d at 343-46 [discussing *International Soc'y for Krishna Consciousness* v. *Lee,* 505 U.S. 672 (1992) (Kennedy, concurring]. {The manner of solicitation may be regulated to guard against fraud and duress (hereinafter "*Lee*"); *United States* v. *Kokinda,* 497 U.S. 720 (1990) (solicitation is disruptive of business and may be regulated); and *Heffron* v. *International Soc'y for Krishna Consciousness, Inc.,* 452 U.S. 640 (1981) (solicitations at a state fair may be confined to designated booths)}.
[20]*Alliance for Survival,* 22 Cal. 4th at 372-73, 993 P.2d at 346.
[21]*See Id.* at 373, 993 P.2d at 346.
[22]*Clark* v. *Burleigh,* 4 Cal. 4th 474 (1992) [hereinafter "*Burleigh*"]. *See generally* Petitioner's Brief at 26-40. Note that Petitioner's Brief appears at one point to misquote *Burleigh.* Petitioner's Brief says:

> "[n]othing in the [California] Constitution requires the *owner of property to which constitutional protections apply* freely to grant access to all who wish to exercise their right to free speech without regard to the nature of the property or to the disruption that might be caused by the speaker's activities."

Petitioner's Brief at 28 (citing *Burleigh,* 4 Cal. 4th at 482) (emphasis added). The proper quotation is:

> [n]othing in the [California] Constitution requires the *Government* freely to grant access to all who wish to exercise their right to free speech *on every type of Government property* without regard to the nature of the property or to the disruption that might be caused by the speaker's activities.

Burleigh, 4 Cal. 4th at 482 (emphasis added). The error is unfortunate, because it mars an otherwise persuasive analysis of *Burleigh.*
[23]*See Burleigh,* 4 Cal. 4th at 482-83.
[24]*See Fashion Valley,* 451 F.3d at 245; Petitioner's Brief at 27.
[25]*See* Petitioner's Brief at 31.

[26]67 Cal. 2d 845 (1967).
[27]*See Id.* at 847.
[28]*See Id.*
[29]*Id.* at 851-52.

Act 52 Amends the Pennsylvania Mechanics' Lien Law of 1963

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On June 29, 2006, Governor Ed Rendell signed Pennsylvania General Assembly House Bill 1637, Printers No. 4229, also known as Act 52 (hereinafter "Act 52"), which amends the Pennsylvania Mechanics' Lien Law of 1963, 49 P.S. 1101, *et seq.* ("PMLL"). It takes effect January 1, 2007.

The primary purpose of Act 52 is to protect contractors and subcontractors by limiting the circumstances in which an owner may obtain a waiver of mechanics' liens from a contractor or subcontractor prior to the time the contractor or subcontractor is actually paid. The impact of Act 52 (the enactment of which was opposed by the Philadelphia Bar Association) is significant to owners, contractors, subcontractors and mortgage lenders.

Prior to Act 52, a contractor or subcontractor could waive his right to file a claim by a written instrument signed by him or by any conduct that operated equitably to estop the contractor or subcontractor from filing a claim. The waiver was effective, even if it was executed before the contractor or subcontractor was paid. Furthermore, prior to Act 52, a mechanics' lien waiver that was executed by a contractor, which provided that a claim could not be filed by a subcontractor, was binding on the subcontractor if (1) the subcontractor had actual notice of the waiver before any labor or materials were furnished by the subcontractor or (2) the contract or a separate written instrument was filed in the office of the prothonotary[1] prior to the commencement of the work on the ground or within ten (10) days after execution of the principal contract or not less than ten (10) days prior to the contract with the subcontractor, indexed in the name of contractor as defendant and the owner as plaintiff, and also in the name of the contractor as plaintiff and the owner as defendant.

If the contract or separate written instrument is indexed electronically, by means of a computer or similar system such that the names of the contractor and owner are electronically retrievable regardless of whether the parties are indexed as plaintiff or defendant, then the contractor can be listed as defendant and the owner as plaintiff, or vice versa.

However, after January 1, 2007 (the effective date of Act 52), a waiver by a contractor or subcontractor will be binding only in the following circumstances:

1. In the case of a residential building[2] where the total contract price between the owner and the contractor is less than $1,000,000, a contractor or subcontractor, or both, may waive their respective rights to file claims against property for the erection, construction, alteration or repair by signing a written instrument or by any conduct which operates equitably to estop the contractor or subcontractor (as the case may be) from filing a claim. Consequently, for residential construction contracts under $1,000,000, the rules are largely the same. In the case of a residential building, a subcontractor also may waive his right to file a claim against the property (irrespective of the contract price between the owner and contractor) by signing a written instrument or by any conduct which operates equitably to estop the subcontractor from filing a claim, provided the contractor has posted a bond guaranteeing payment for labor and materials provided by the subcontractor(s). For residential construction contracts of $1,000,000 or more, the contractor is held to a higher standard, and the surety market will be enriched by the need for labor and material bonds.

Except as provided in the first two rules, (a) a waiver executed by a contractor is valid only if it is given in consideration for payment for work, services, materials or equipment provided, and only to the extent payment is actually received; and (b) a waiver executed by a subcontractor is valid only if (i) it is given in consideration for payment for work, services, materials or equipment provided, and only to the extent payment is actually received; or (ii) the contractor has posted a bond guaranteeing payment for labor and materials provided by the subcontractor(s). Any other waiver is against public policy, unlawful and void.

If lien rights may be waived as set forth above, then a mechanics' lien waiver executed by a contractor that provides that a claim cannot be filed by a subcontractor is binding on the subcontractor if (a) the subcontractor has actual notice of the waiver before any labor or materials are furnished by the subcontractor; or (b) the contract or a separate written instrument is filed in the office of the prothonotary prior to the commencement of the work on the ground or within ten (10) days after execution of the principal contract or not less than ten (10) days prior to the contract with the subcontractor, indexed in the name of contractor as defendant and the owner as plaintiff, and also in the name of the contractor as plaintiff and the owner as defendant (subject to the same electronic indexing exception mentioned above). This last rule just brings us full circle to the traditional requirements of mechanics' lien waivers under the PMLL prior to the enactment of Act 52. However, it is only applicable in the case of residential construction contracts under $1,000,000.

Act 52 also includes a change to the definition of "subcontractor." Prior to Act 52, the definition was limited to a person (other than an architect or engineer), who by express or implied contract with the contractor, erects, constructs, alters or repairs an improvement or any part thereof, or who furnishes labor, skill or superintendence thereto, or supplies or hauls materials, fixtures, machinery or equipment reasonably necessary for and actually used therein, or any of the foregoing,

whether as superintendent, builder or materialman. Act 52 expands the definition of subcontractor to include a person who enters into a contract with a subcontractor that is in direct privity with the contractor (i.e., a second-tier subcontractor).

The time within which a claimant is required to file a claim following completion of the work has also been extended from four (4) months to six (6) months. Furthermore, Act 52 eliminates the requirement that a subcontractor provide an owner (in the case of alterations or repairs) with a preliminary notice of intention to file a claim prior to completion of the work.

Lenders will be pleased to learn that Act 52 amends the lien priority rules afforded mechanics' liens by making them subordinate to: (1) purchase money mortgages [as defined in 42 Pa.C.S. § 8141(1)] and (2) open-end mortgages [as defined in 41 Pa.C.S. § 8143(f)], the proceeds of which are used to pay all or a portion of the cost of completing erection, construction, alteration or repair of the property secured by the open-end mortgage. This change provides purchase money mortgage lenders and construction lenders with additional protection, knowing that they cannot be primed by a disgruntled contractor—though non-purchase money mortgage lenders and lenders that are not advancing funds for construction still need to be anxious when construction is already underway.

As is often the case with new legislation, Act 52 raises some interesting questions and comments. For instance:

- The statute does not prohibit contractors or subcontractors from subordinating their mechanics' lien rights.
- If an open-end mortgage qualifies for the super-priority afforded by Act 52, will Act 52 also protect the mortgagee with respect to advances for taxes, assessments, maintenance charges, insurance premiums or costs incurred for the protection of the mortgaged premises or the lien of the mortgage or by reason of a default of the mortgagor under the mortgage?
- What qualifies as a statutorily sufficient bond guaranteeing payment for labor and materials provided by subcontractors?
- Will an owner (and its mortgage lender) be tempting fate if the owner takes a set-off against payments due the contractor to cure defective work that was previously paid for?
- The definition of "residential building" is somewhat circuitous.

Is there any inconsistency between the rights now afforded second-tier sub-subcontractors under Act 52 and the release provisions of the Pennsylvania Contractor and Subcontractor Payment Act (73 P.S. 501 et seq.)?

Even though the up-front mechanics' lien waiver is of limited use post-Act 52, an owner should make sure that subcontractors are provided with actual notice of the total amount of the contract between the owner and the contractor in order to avail itself of the protection afforded by 49 P.S. §1405 (which was not amended by Act 52).

Only time, litigation, further amendments or new legislation will answer these and other questions that will undoubtedly arise. In fact, practitioners may not have to wait very long for answers. On June 13, 2006, Representative Bob Allen introduced House Bill 2756 (Printers No. 4207), which repeals the PMLL and replaces it with an entirely new mechanics' lien statute.

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[1]The prothonotary is the chief court clerk in certain courts of law in certain Anglo-American jurisdictions, including the American states of Pennsylvania and Delaware, the Federal Court of Canada, the Canadian provinces of Nova Scotia and Prince Edward Island, and the Supreme Courts of the Australian states of New South Wales and Victoria.

[2]Act 52 defines a residential building to be property on which there is a residential building, or which is zoned or otherwise approved for residential development, planned development or agricultural use, or for which a residential subdivision plan or planned residential development plan has received preliminary, tentative or final approval pursuant to the Pennsylvania Municipalities Planning Code.

Contaminated Property: When the Agency Delays, Who Pays?

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Property owners have experienced it: the delay that sometimes seems inevitable and inherent in review by environmental agencies. That delay can cost landlords money, particularly when a shopping center has had historical tenants, such as dry-cleaners and gas stations that may have an impact on the property. A recent case decided by the United States Court of Appeals for the Third Circuit has important implications for how damages resulting from delay can be claimed and awarded.

Jaasma v. *Shell Oil Company*, 412 F.3d 501 (2005), involved a dispute between a landlord and her tenant. The case is significant because damages were awarded against a tenant who lived up to its obligations under the lease and promptly remediated the contamination it caused. Despite this action, the landlord claimed that she had been damaged because the environmental agency overseeing the clean-up did not issue a "no further action" ("NFA") letter until more than two years later. That delay, she said, made the property unmarketable because no one would buy it without final agency approval. Despite the tenant's argument that it had no control over the agency, the court agreed and held the tenant liable.

Facts of the Case

Alice Jaasma leased a parcel in West Paterson, N.J., to Shell Oil Company in 1988. The lease contained provisions requiring Shell and its assignee to remove all gasoline, waste oil and fuel-oil tanks from the premises upon termination of the lease and restore the property to its original state.

In October 2001, one week before the end of the lease, Shell removed the underground storage tanks and discovered petroleum contamination adjacent to the tanks. It promptly reported the contamination to the New Jersey Department of Environmental Protection ("NJDEP"). Shell then remediated the contamination by excavating 6,500 tons of soil and replacing it with clean fill. Three months after the lease expired, Shell prepared and filed a report with NJDEP detailing its activities and concluding that the remediation was complete. The report requested issuance of an NFA letter.

In April 2002, NJDEP acknowledged receipt of the report, but requested re-sampling of the property due to technical deficiencies in the sampling methodology. The re-sampling was not completed until September 2003. Twenty-eight months after the original clean-up was completed, NJDEP issued an NFA letter, stating that applicable standards had been met and no further action was required.

In her claim, the landlord did not dispute that the tenant had successfully remediated the site in October 2001. Instead, she alleged that due to NJDEP's ongoing review and the uncertainty surrounding the environmental status of the property, she was unable to sell or rent the property at fair market value (FMV) for the 28-month period from the expiration of the lease until NJDEP issued the NFA letter. In support of her claim, she presented evidence that three different realtors concluded she would not receive FMV for the property during that period, as she could not warrant the condition of the property to prospective purchasers without an NFA letter. In addition, several prospective purchasers had made an NFA letter a condition of sale.

The court held that the landlord could recover damages from the tenant for the delay, reversing the district court's decision that the landlord had not suffered cognizable damages. It also determined that "loss of use" was an appropriate measure of damages during the period after the clean-up was complete, but before the NFA letter had been received. It agreed with the landlord that the regulatory uncertainty during that period meant that the property could not be sold or rented at FMV.

The Third Circuit's opinion makes clear that "clean" sampling results may not be sufficient to foreclose claims for damages. Without final approval by a regulatory agency, lingering concerns may be enough to diminish the FMV of the property.

The Future

The *Jaasma* opinion will likely be followed by other state and federal courts because it relies not only on the law of property in New Jersey, but also on general common law principles of property rights. Landlords should now include indemnification provisions for loss of use damages in leases as a matter of course. The lease should also specify that no remediation is complete until an NFA letter or similar document is issued by the applicable regulatory agency. The good news for landlords is that contaminated properties may become more appealing to prospective purchasers if purchasers believe they can recover the property's fair market rental during the regulatory approval process. The bad news for tenants is that damages may be assessed against them for a delay over which they have no control. That possibility counsels in favor of initiating and completing clean-ups well before expiration of the lease, whenever possible.

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Of Interest

Articles

Daniel Carragher, “True Lease or Disguised Financing? The ‘State’ of the Law,” 25-JUN *Am.Bankr.Inst.* J. 34 (June 2006).
Evan Hollander, “Fifth Circuit Adopts ‘Actual’ Test in Handling Exception to *Ipso Facto* Provisions,” 25-MAY *Am.Bankr.Inst.* J. 1 (May 2006).
Ryan W. Johnson, “Post-Closing Demands for Mortgage-Related Fees Assessed During a Chapter 13 Plan—Part II: Legality of the Post-Closing Collection of Mortgage-Related Fees,” 25-Jun *Am.Bankr.Inst.* J. 18 (June 2006).
Stuart Larsen, “Understanding the New Semi-Automatic Stay,” 25-APR *Am. Bankr. Inst.* J. 22 (April 2006).
Kenneth M. Misken, “Setoff of Rejection Damages Under § 553: A Strained and Imaginative Interpretation?” 25-AUG *Am. Bankr. Inst.* J. 36 (July/August 2006).
Jason D. Schauer, Kerri A. Lyman, “Carving up the Contract Turkey Under Bankruptcy Code Section 365: Severability and Indivisibility, Integration and Aggregation in Acquisition Transactions,” 15 *J. Bankr.L. & Prac.* 3 Art. 3 (June 2006).
Daniel Sklar, “Consenting to an Order Partially Lifting the Automatic Stay Bars Trustee From Later Substantive Consolidation,” 25-JUN *Am.Bankr.Inst.* J. 32 (June 2006).
Arthur Steinberg & Scott I. Davidson, “Section 365 of the Code: When Does Being in Possession Not Mean ‘In Possession’?” 25-AUG *Am. Bankr. Inst.* J. 50 (July/August 2006).

Cases

Bankruptcy

The Bankruptcy Code section requiring the trustee to timely perform the debtor’s post-petition, pre-rejection lease obligations entitles lessors to immediate payment of post-petition rent owing under the debtor’s unexpired leases, without regard to whether the estate is administratively solvent. *In re C.Q., LLC,* 343 B.R. 915 (Bkrtcy. W.D.Wis. 2005).

The statutory cap on landlord claims for lease termination damages significantly reduces the amount of the landlord’s claim in a pre-petition state court judgment entered against the debtor for accrued rent after the debtor vacated the premises and the landlord repossessed them. *In re Tittle,* 346 B.R. 684 (Bkrtcy .E.D. VA. 2006).

Triple-net leases executed by the debtor are true commercial leases where both a motor vehicle sales and a repair business are operated on the subject property; the debtor was required to assume or reject the leases and could not disguise the leases as financing arrangements. *In re Morande Enterprises, Inc.,* 346 B.R. 886 (Bkrtcy.M.D. Fla. 2006).

A trustee of an economically defunct debtor that could not generate the income needed to perform under its unexpired commercial lease could not assume the lease for the purpose of assigning it to a third party free and clear of the landlord’s interest. The proposed sale did not satisfy any of the conditions for a sale, and the debtor could not provide adequate assurance of future performance. *In re Southwest Florida Heart Group, PA,* 342 B.R. 639 (Bkrtcy. M.D. Fla. 2006).

A limited liability company that entered into a pre-petition contract to purchase unimproved land from the debtor was not a “purchase in possession” that was entitled to any special protection under the Bankruptcy Code when the debtor decided to reject the executory sales agreement. *In re Chicago Hudson, LLC,* 345 B.R. 887 (Bkrtcy. N.D.Ill. 2006).

A brokerage filed proof of claim for commissions that it allegedly earned providing services to the debtor. Brokerage services were sufficient to subject its claims for commission to the applicable statute that barred real estate agents from collecting commissions in the absence of a written listing agreement. The letters setting forth the terms of the purported agreement did not constitute a written agreement between the brokerage and the debtor. Nor could the brokerage assert rights as a third-party beneficiary under the purchase agreement between the debtor and the purchaser. *In re Capitol Hill Group,* 344 B.R. 709 (D.D.C. 2006).

As an apparent matter of first impression, a landlord’s security interest in a certificate of deposit held by way of the assignment of the original landlord’s perfected security interest was perfected as against the debtor’s creditors and transferees without additional filing. *In re Verus Investment Management, LLC,* 344 B.R. 536 (Bkrtcy.N.D. Ohio 2006).

A special facilities and ground lease agreement between a municipality and an airline, with its interdependent ground and facilities provisions, was a single, inseverable whole under state law and had to be treated as a true lease rather than a disguised security agreement. *In re United Air Lines, Inc.,* 453 F.3d 463 (7th Cir. 2006).

An airline’s unilateral option contract was a legal interest of the debtor airline in property and, therefore, was included in the bankruptcy estate. Because the lender had no obligations under the contract until the debtor-airline satisfied conditions precedent for the exercise of the option and elected to require the lender to finance its purchase of planes, the option was not an executory contract that the debtor must choose to assume or reject. *BNY, Capital Funding, LLC. v. US Airways, Inc.,* 345 B.R. 549 (E.D.Va. 2006).

Where the landlord does not make a claim in the tenant’s bankruptcy proceeding, it is not precluded from seeking the remedies contained in the parties’ lease. *In re: Stonebridge Technologies, Inc.,* 430 F.3d 260 (5th Cir. 2005).

The security interest that a bank possessed in a restaurant's "deposit accounts" extended only to deposit accounts that were the proceeds of collateral in which the bank had an original Article 9 security interest. The bank to which the restaurant had assigned its interest in accounts receivable had an interest in those accounts subject to any setoff rights possessed by the hotel. *In re Timothy Dean Restaurant & Bar,* 342 B.R. 1 (Bkrtcy.D. Dist.Col. 2006).

A mortgagee sought relief from the automatic stay, and the court held that the debtors failed to establish that there was a realistic prospect of an effective reorganization within a reasonable time; therefore, stay relief was warranted. *In re State Street Associates, L.P.,* 342 B.R. 32 (Bkrtcy. N.D.N.Y. 2005).

A debtor airline brought an adversary proceeding to determine that certain of its payment obligations for improvements at airports were not rental obligations arising under leases. The court concluded that the lease-and-leaseback arrangement was not a "true lease," but a disguised "security agreement." *In re United Air Lines, Inc.,* 447 F.3d 504 (7th Cir. 2006).

A debtor-pier owner moved to reject its executory lease-sales agreement with a lessee that used a portion of the pier to operate a water park. The court held that under state law the lease and the sale contract were independent, divisible components of the parties' agreement; that the lessee was not a "purchaser in possession" within the meaning of the Code; and that the lessee's cause of action for specific performance was a "claim" that could be discharged in bankruptcy. *In re Nickels Midway Pier, LLC,* 341 B.R. 486 (D.N.J. 2006).

Condemnation/Eminent Domain

Georgia law authorizes condemnation for sale to a private party for private use. *Talley v. Housing Authority of Columbus,* Ga.Ct.App., 279 Ga. App. 94; 630 S.E.2d 550, April 5, 2006, reconsideration denied, April 26, 2006.

In dividing a compensation award between a tenant and subtenant, the court can enforce a lease provision entitling the subtenant to lost profits. *City of Roeland Park* v. *Jasan Trust*, 132 P.3d 943 (Kan. 2006).

Municipalities may condemn an individual dwelling that is blighted or deteriorated, even if it is not in a slum or blighted area. *City of Frederick* v. *Pickett,* 392 Md. 411, 897 A.2d 228, Md.Ct.App., April 19, 2006.

In valuing agricultural land taken for airport expansion, the court properly excluded testimony that the highest and best use was commercial or industrial. *Tunica County* v. *Matthews,* 926 So. 2d 209 (Miss. 2006).

A home rule city could condemn property for a public golf course under a Third Class City code in the absence of any superceding and uniform statewide statute precluding the taking. In re *Condemnation by the City of Coatesville,* Pa. Commonwealth Ct., April 13, 2006.

A determination of blight, made 15 years earlier, retains a strong presumption of validity in an eminent domain proceeding; however, the current status of the property must be considered. *Norfolk Redevelopment and Housing Authority* v. *C&C Real Estate, Inc.*, 630 S.E.2d 505 (Va. 2006).

Rezoning of property historically operated as a bar, to prohibit alcohol sales, constituted a taking. *City of San Antonio* v. *El Dorado Amusement Co., Inc.*, 195 S.W.3d 238, Tex.Ct.App., Feb. 15, 2006, rehearing denied, April 27, 2006.

Condemnation of an easement to control a parking garage was not for a public purpose where the condemning authority had an option to buy the garage at a much higher price. *Rhode Island Economic Development Corp.* v. *The Parking Co., LP,* 892 A.2d 87, (R.I. 2006).

A developer who bought with knowledge of a Planned Use Development is bound by agreement to restore wetlands and is not entitled to compensation. *Palm Beach Polo, Inc.* v. *Village of Wellington,* 918 So. 2d 988 (Fla.Ct. App. 2006), review denied 929 So. 2d 1053 (Fla. 2006).

Employment

An employee cannot maintain an action for employment discrimination against his former employer on the grounds of sex and age discrimination without proof of a hostile work environment or that he was terminated under circumstances that gave rise to an inference of discriminatory intent based upon his age. *Drummond* v. *IPC International,* 400 F. Supp. 2d 521 (E.D.N.Y. 2005).

Environment

An ordinance that prohibits discount superstores, based on traffic congestion and the negative impact on neighborhood centers, is a valid exercise of police power and does not require environmental review under the state environmental quality act. *Wal-Mart Stores, Inc.* v. *City of Turlock,* 138 Cal.App. 4th 273 (Cal.Ct.App. 2006).

An alternative urban area-wide review of development of 667 acres on the Mississippi River was adequate, despite not analyzing cumulative impacts outside the project area. *Minnesota Center for Environmental Advocacy* v. *City of St. Paul Park,* 711 N.W.2d 526 (Minn.Ct.App. 2006).

Fees

A development fee and impact fee waiver agreement between previous city mayors and property owners was void pursuant to the municipal corporation statute and city charter, which require the board of aldermen to enact fee ordinances. *Twigg* v. *Riverside Apartments, LLC,* 896 A.2d 439 (Md. Ct. App. 2006)

Development impact fees constitute an unauthorized tax and are void absent the grant of specific statutory enabling authority. *Mayor* v. *Homebuilders Assoc. of Mississippi, Inc.,* 932 So. 2d 44 (Miss. 2006).

County-imposed school impact fees are illegal, absent specific statutory enabling authority. *Durham Land Owners Assoc.* v. *County of Durham,* 630 S.E.2d 200 (N.C.App.Ct. 2006).

A former client is required to pay attorney fees where the attorney establishes reasonable litigation and billing practice and the client cannot show that any error claimed by the client was material to the outcome of her matter. *Loosemore* v. *Street,* Case No. 2:05CV00008, United States District Court for the Western District of Virginia, Big Stone Gap Division, Nov. 2, 2005.

Guarantees

A guarantee is unenforceable if it is made subsequent to the original lease and unsupported by new consideration or if amendments to the lease are executed without the guarantor's knowledge or consent. *Birts* v. *Mott,* Civil Action No. SA-03-CA-1127-XR, United States District Court for the Western District of Texas, San Antonio Division, Feb. 6, 2006.

Insurance

Pursuant to a commercial general liability policy, an insurer was required to pay a retailer's legal obligation to pay damages because of an "advertising injury." A suit by Gucci America Inc. alleged the retailer's trademark infringement and unfair competition. The insurer disclaimed coverage for Gucci's failure to claim advertising injury. In the retailer's action seeking indemnification and a declaration of the insurer's duty to defend, the district court held that Gucci's complaint did not bring the case within the insurance policy's coverage. In remanding the action, the appellate court held that the underlying complaint stated a claim bringing the action within the defendant insurer's coverage. It found that Gucci's claim that the plaintiff retailer "marketed" allegedly infringing goods may be construed to include activities apart from selling and distribution that are "within the embrace" of "advertising" as used in the policy to describe the plaintiff's coverage. *Century 21 Inc.* v. *Diamond State Insurance Co.,* 442 F.3d 79 (2nd Cir. 2006).

Landlord & Tenant

A landlord is not entitled to damages suffered due to lost rent where the settlement agreement entered into between the landlord and the former tenant does not include payment of lost rent. *Tiny Treasures Academy & Get Well Center, Inc., and Rachel Kimberly Boyd* v. *Stirling Place, Inc.,* 916 So. 2d 991 (Ct. App. Fl., 4th Dist. 2005).

A tenant's jury award may be doubled where the landlord engaged in unfair and deceptive practices; an award of attorney fees also may be appropriate. *Plastics Color & Compounding, Inc.* v. *Henry W. Coz et al.,* 20 Mass. L. Rep. 453 (Sup. Ct. Mass. 2006).

A determination that a corporate veil should be pierced cannot be made at the summary judgment stage where a more factually intensive determination of the facts is necessary. *The Mall at IV Group Properties, LLC., et al.* v. *Roberts et al.,* Civil Action No. 02-4692 (WHW), United States District Court for the District of New Jersey, Dec. 8, 2005.

The corporate veil may be pierced where the evidence clearly establishes no line between the corporate entity and the individual president/director/shareholder. *East Market Street Square, Inc.* v. *Tycorp Pizza IV, Inc.,* 625 S.E.2d 191 (N.C. Ct. App. 2006).

Leases

A tenant may be found to have breached the lease if it fails to find an assignee within the requirements of the lease, and then fails to pay rent through the lease term. *GMS Management Co., Inc.* v. *Vliet,* C.A. No. 22807, Court of Appeals of Ohio, Ninth Appellate District, Summit County, Feb. 8, 2006.

A tenant's obligation to pay rent is an independent obligation absent a set-off clause in the lease. *Green 440 Ninth LLC* v. *Duane Reade,* 10 Misc. 3d 75; 809 N.Y.S.2d 756, (Sup. Ct. N.Y., App. Term, 1st Dept. 2005).

Where a lease provides for indemnification in certain circumstances, but the lease is susceptible to conflicting interpretations, summary judgment cannot be granted because issues of fact exist. *Brown* v. *Airport Industrial Limited Partnership,* CV000596353, Superior Court of Connecticut, Judicial District of Hartford, at Hartford, Oct. 17, 2005.

Signage

An ordinance prohibiting pole signs is valid. *G.K. Ltd.Travel* v. *City of Lake Oswego,* 436 F.3d 1064 (9th Cir. 2006).

A company that had applied to the state highway department for permits to erect billboards in the rights-of-way of interstate highways did not have a protected vested interest when the county enacted an ordinance requiring location permits. *Metro Development Commission of Marion County* v. *Pinnacle Media, LLC,* 846 N.E.2d 654 (Ind. 2006).

Tort Liability

Where a tenant has exclusive control over the leased premises and is aware of the dangerous condition that causes an injury, the landlord has no liability for the injury. *Haines* v. *Corner, Inc.,* 920 So. 2d 1289, (Ct. App. Fla., 4th Dist., 2006).

The legal relationship between the owner and the premises is not necessarily severed completely once the premises are leased by the owner; the owner may be liable for injuries that subsequently occur on the premises. *Russ* v. *Wollheim,* 915 So. 2d 1285, (Ct. App. Fl., 2d Dist., 2005).

Zoning

An applicant for a mixed-use development did not have a vested right to develop under previous zoning because it had not obtained a significant government act upon which it relied. *Board of Supervisors of Culpeper County* v. *Greendale, LLC,* 626 S.E.2d 357 (Va. 2006).

A state statute requiring the government to compensate a property owner for a reduction in the market value of his property, attributable to land use regulations or to modify, remove or not apply those regulations, was valid. *MacPherson* v. *Department of Administrative Services,* 340 Ore. 117; 130 P.3d 308 (2006).

Rezoning for a megastore was in substantial compliance with a growth plan encouraging a residential and small business environment. *Citizen Advocates for a Livable Missoula, Inc.* v. *City Council,* 331 Mont. 269; 130 P.3d 1259 (2006).

A sign ordinance with restrictions on off-premises signs is constitutional. *Covenant Media of llinois LLC* v. *City of Elgin,* D.N.D. Ill., March 7, 2006, reconsideration denied, May 23, 2006.

The city denied Wal-Mart's request for a zoning change to provide parking, and then denied the site plan approval for its store because it was dependent on the zoning change. A few months later, Wal-Mart submitted a new application for a multi-level parking structure, which did not require any zone change. Wal-Mart appealed, and the court found that the city had properly focused on the substance of the proposed use to determine whether the second application was substantially similar to the first. *Wal-Mart Stores, Inc.* v. *City of Oregon City,* 204 Ore. App. 359, 129 P.3d 702 (Ore. Ct. App. 2006), review denied, 341 Ore. 80 (2006).

Legislation

EMINENT DOMAIN

Colorado—2006 New Laws, S.B. No. 06-154, codifies existing eminent domain provisions to facilitate understanding and identify the procedural requirements for exercise of the power

—2006 New Laws, S.B. No. 06-078, prohibits exercise of eminent domain for private toll road

Florida—2006 New Laws, H.B. No. 1567, 1569 restricts certain transfers of property taken by eminent domain

—2006 New Laws, H.B. No. 683. amends development-of-regional-impact review provisions

—2006 New Laws, H.B. No. 273, provides view zones for billboards in certain locations

Maine—2006 New Laws, H.B. No. 1310 and L.D. No. 1870. prohibit exercise of eminent domain for certain purposes

Nebraska—2006 New Laws. L.B. No. 924, restricts eminent domain for economic development

Utah—2006 New Laws, S.B. No. 117 limits exercise of eminent domain by municipalities by expanding the public uses for which eminent domain my be used

Virginia—2006 New Laws, H.B. No. 955. adds religious corporation and church to eminent domain code

FEES

Utah— 2006 New Laws, S.B. No. 267 makes various changes regarding impact fees and land use application procedures

REDEVELOPMENT

Utah—2006 New Laws, S.B. No. 196 creates a three-track approach to redevelopment

ROADS

Virginia—2006 New Laws, S.B. No.681 amends provisions related to cash proffers for road improvements.

VESTED RIGHTS

Utah—2006 New Laws, H.B. No. 132 prohibits municipalities from imposing "unexpressed" requirements on permits

ZONING

Virginia—2006 New Laws, S.B. 373 authorizes transfer of development rights

From Canada

In Depth

An Overview of Canadian Insolvency Law and Cross-Border Considerations

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Introduction

Constitutional Background

Canada has a federal system of government. Legislative jurisdiction is divided between the federal legislature (Parliament) and the legislatures of Canada's 10 provinces. Bankruptcy and insolvency is a matter of federal jurisdiction. Accordingly, in principle, bankruptcy and insolvency law and practise should be uniform across Canada.

However, property and civil rights, which include the areas of real and personal property and the creation and realization of security, are matters of provincial jurisdiction and differ from province to province. The juxtaposition of these provincial laws and federal bankruptcy and insolvency laws gives rise to some provincial differences.

Moreover, the courts having jurisdiction in bankruptcy and insolvency matters across Canada are provincially administered courts of general jurisdiction that are staffed by federally appointed judges. Judges exercise general jurisdiction within a province; there are no "bankruptcy judges," although the courts of some of the provinces have organized themselves in such a way as to promote specialization of judges. There is some variance from province to province in the way the courts function.

Statutory Framework

Canada has two main federal statutes dealing with insolvency: the *Bankruptcy and Insolvency Act* ("BIA") and the *Companies' Creditors Arrangement Act* ("CCAA"). The BIA deals both with full bankruptcy (analogous to Chapter 7 of the U.S. Bankruptcy Code, but with many differences) and the reorganization of corporations and individuals.

The CCAA deals with the reorganization of corporations or corporate groups having aggregate liabilities of at least $5 million. This statute is Canada's closest equivalent to Chapter 11 of the U.S. Bankruptcy Code, but there are great differences in the laws, the practises and, to some extent, the policies of the laws.

The reorganization system provided by the BIA is rather rigid. While it provides a relatively quick, simple and inexpensive system of reorganization, it lacks the flexibility usually required for the reorganization of larger enterprises. Typically, it is used for the reorganization of small and medium-sized businesses. Reorganizations of large entities are usually conducted through the CCAA process.

Both the BIA and the CCAA have been the subject of a recent statutorily mandated review conducted by the Government of Canada in consultation with a number of representative groups. In November 2005, on the eve of the dissolution of the Canadian Parliament [consisting of Canada's two (2) legislative houses] preceding a general election, Parliament passed the *Act to establish the Wage Earner Protection Program Act*, to amend the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* and to make consequential amendments to other Acts *("Reform Act")*. The *Reform Act* was passed in haste in the midst of consultation and analysis of draft legislation, which had given rise to considerable substantial and technical concerns and comments. In recognition of this situation and at the urging of the Canadian Senate (one of the houses of Parliament), the Government advised that proclamation into force of the *Reform Act* would be deferred until June 30, 2006, in order to allow the completion of the process of analysis and possible amendments. A general election in January 2006 gave rise to a change of government, and the *Reform Act* has still not come into force. It is unknown how and when the new government will deal with the *Reform Act.* We believe that it is likely that the substance of the *Reform Act* will eventually come into force—either through an amended version of the *Reform Act* or through a new act. And when such reform becomes law, it is expected that there will be a greater degree of consistency between the BIA and the CCAA, and much of what was previously a judicial order-driven process under the CCAA will be codified.

The Canadian Psyche: Differences Between Canadian and U.S. Law and Practise

The differences between Canadian and U.S. law and practises cannot be understood merely by way of a comparison of the differences in the respective statutes. There are also significant systemic and cultural differences.

The Canadian process tends to be less litigious. Litigation plays a much smaller role in Canada than in the United States. Negotiation among stakeholders plays a major role, which is generally strongly encouraged by the courts.

There is no constitutional protection in Canada for property rights as there is in the United States. This leads to differences of approaches in insolvency law in Canada and in the United States. For example, in Canada, there is no clearly defined concept that is similar to the U.S. "adequate protection" concept.

Canada has a system of federally licensed bankruptcy trustees. Trustees are professionals who are usually chartered accountants (the Canadian equivalent of CPAs). The major accounting firms all have bankruptcy and restructuring departments headed by bankruptcy trustees. Licensed trustees serve as trustees in full bankruptcy proceedings and as monitors in reorganization proceedings. They are officers of the court, and the courts typically place a great deal of reliance on their views and recommendations.

The Canadian system of reorganization, especially under the CCAA, is characterized by a great deal of judicial flexibility. Even if the reforms under the *Reform Act* take root at some point in the near future, it is expected that the rules will remain much simpler and less technical than is the case under the U.S. Bankruptcy Code.

Typically, bankruptcies and reorganizations in Canada are conducted, and concluded, much more expediently, and with considerably less expense, than under the U.S. Bankruptcy Code.

Currently, Canadian legislation does not distinguish between "shareholder-related claims" and "ordinary creditor claims." This creates the potential for serious injustice, and is seen as a systemic flaw. One of the reforms embodied in the *Reform Act,* and expected to be included in whatever amendments to the BIA and CCAA are eventually enacted, provides for deferred status for shareholder-related claims. In light of this change, and the factors referred to above, Canada should be considered a very hospitable jurisdiction for instituting main proceedings in a cross-border context.

General Overview

This article is not intended as an exhaustive analysis of the Canadian insolvency system. It seeks only to summarize the salient features of the system, and to provide a glimpse into the context and dynamics of the system and the comparative features of the Canadian and recently enacted U.S. Bankruptcy Code regimes on cross-border insolvency proceedings.

Bankruptcy (Chapter 7 Equivalent)

The term "bankrupt" in Canada applies only to a situation where the debtor's assets have vested in a bankruptcy trustee for the purpose of liquidation. A reorganizing debtor is not referred to as "bankrupt" or as having gone into bankruptcy, although a debtor in the process of reorganization is sometimes referred to as being "under bankruptcy protection."

A debtor becomes bankrupt by either a voluntary assignment of his property to his creditors generally, a forced "receiving order" issued on the initiative of one or more creditors, or upon the failure of a BIA "proposal" to obtain creditor acceptance or court approval.

The assets are liquidated by the trustee under the supervision of a committee of creditors known as inspectors. If appropriate, the trustee conducts an investigation into the affairs of the debtor and institutes the appropriate recovery proceedings.

Reorganization Under the BIA

The BIA provides for a system of reorganization that is initiated by a debtor filing either a proposal or a notice of intention to file a proposal ("NOI"). "Proposal" is the term used in the BIA for a plan of compromise.

Should the reforms embodied in the *Reform Act* see the light of day in some form, the BIA reorganization process will provide a debtor with more flexibility than was previously the case, thereby rendering the BIA process more akin to that under the CCAA.

The filing of a NOI brings with it an automatic stay of proceedings in favor of the debtor for an initial period of 30 days, which can be extended for successive renewals for periods not exceeding 45 days, with a statutory maximum stay period, preceding the filing of a proposal, of six months. The filing of a proposal also gives rise to an automatic stay.

A proposal must be filed during the stay period following the filing of a NOI, failing which the debtor becomes automatically bankrupt. If the creditors fail to accept the proposal, or if the accepted proposal is not approved by the court, the debtor is deemed to be bankrupt.

The BIA's reorganization regime in its current form contemplates little more than the compromise of debt. One of the most radical changes proposed by the *Reform Act* is to broaden the scope of what can be accomplished under this regime. This ranges from permitting a debtor to disclaim a broad spectrum of executory contracts to facilitating debtor-in-possession financing ("DIP") and other substantial debtor relief to date available only under the CCAA's reorganization system. Even if the *Reform Act,* or something largely resembling it, becomes the law in Canada, such that there will be greater consistency between the BIA and the CCAA regimes, it is likely that most major reorganizations will continue to be conducted under the CCAA.

Introduction

The CCAA was enacted in the 1930s, at the time of the Great Depression, as a mechanism to provide relief for insolvent corporations. The statute fell out of use, and was almost totally ignored until the early 1980s. Since that time, it has been used as the statute of choice for the reorganization of large insolvent corporations and corporate groups.

In its current form, the CCAA is a very short statute. It was somewhat modernized and extended by two sets of amendments in the 1990s. One of the main thrusts of reform embodied in the *Reform Act* and likely to be carried through into law in the near future is to provide more rules and guidelines than is and has been the case—mainly through the codification of much of what has been a judicial order-driven process under the CCAA. Restructuring under the CCAA is available only to corporations or groups of corporations having debts totaling at least $5 million.

The text of the CCAA provides very little enlightenment on how the system actually works. In practise, the courts, essentially through the exercise of their inherent jurisdiction, have greatly expanded the scope of the CCAA and have crafted what is, in effect, a customary regime of reorganization of large insolvent corporations. The *Reform Act,* if proclaimed into force, would provide a codification of much of this customary regime. It is contemplated that even if the *Reform Act* or something similar to it is proclaimed into force, the CCAA will still provide significant scope for the exercise of judicial discretion and the crafting of creative solutions.

The positions taken by the courts on various aspects of reorganization under the CCAA vary greatly from province to province. This gives rise to a degree of forum shopping, which has been facilitated by a very flexible interpretation of the provisions of the CCAA dealing with geographical jurisdiction. In this regard, the courts of the province of Ontario are seen as being very efficient and receptive to the CCAA process and to the creative solutions proposed thereunder. Accordingly, many of the most important restructurings under the CCAA to date have taken place in Ontario without regard to where the "center of gravity" of the reorganizing corporation was located.

Certain Features of the CCAA

The following is a description of certain features of the practise, which have evolved under the CCAA and which will likely be codified, to varying extents, further to the *Reform Act* or reform legislation akin to it.

Stay of Proceedings

The CCAA in its current form provides little guidance as to the form or substance of the stay of proceedings, other than to provide limitations in certain closely defined areas. For example, the CCAA precludes an order for the obligatory extension of credit, an order preventing the closing out of a widely defined category of "eligible financial contracts," or an order precluding the drawing on a letter of credit. Under the *Reform Act,* prohibited renunciations would extend to collective agreements; financing agreements where the debtor is a borrower; and, to a certain extent, a licensee's ability to continue using the debtor's intellectual property.

Stay orders under the CCAA are as complex as the statutory provisions of the CCAA concerning the stay are simple. Such orders typically give the debtor the right to renounce executory contracts, except those for which there is a statutory prohibition. There is no necessity for a debtor to adopt executory contracts; they remain in force unless otherwise affected by an order.

CCAA stay orders sometimes extend to the relationships between third parties; the broad reach of such orders will not diminish under any new regime that comes into force. For example, there have been instances wherein it has been ordered that fellow shopping center tenants of a reorganizing retailer were prohibited from exercising recourses against their landlord, which would otherwise have been triggered by the debtor's renunciation of a lease in a shopping center. As a result of the far-reaching scope of stay orders, the course of the reorganization is very often set, without significant creditor input, well before a plan is filed.

DIP Financing

The CCAA in its current form does not deal with DIP financing. The general principle in Canadian reorganization law (whether under the CCAA or the BIA) is that the corporation continues. No new "estate" is created by the filing of proceedings. The debtor remains subject to the same security interests as before the filing. Accordingly, for example, if the issue is not addressed in an order, an existing secured lending arrangement can continue.

The *Reform Act* would provide the first statutory codification of courts' power to authorize DIP lending facilities and the related super-priority security charge in the CCAA, and extends it to BIA restructurings. The extent of the new security charge and DIP financing that may be authorized is intended to be a function of the debtor's cash needs over the first 30 days of a restructuring, subject to adjustment upon notice to affected secured creditors. Courts will be called upon to consider a number of criteria when deciding whether to permit DIP financing and authorize the super-priority charge.

Wage-Earner Protection

Much of the impetus behind the *Reform Act* was related to a perceived need to improve the fate of current and former employees in insolvencies. To that end, the *Reform Act* would provide employees, under both the BIA and the CCAA, with a first-ranking super-priority on "current assets" for wages and a super-priority on all assets for certain current services and pension contribution entitlements. Employees may also receive compensation from a newly created, government-administered, "wage earner protection program." Payments made under this program will be recoverable by the governmental authority through its subrogation to the employees' rights.

Corporate Governance and the Role of the Monitor

The *Reform Act* contemplates significant judicial input into corporate governance of restructuring debtors, including the power to remove directors and to provide indemnification of directors against certain post-filing personal liabilities. While the role of the monitor, as defined by the CCAA, is rather limited, it is extremely important in practise. Stay orders frequently create a substantially expanded role for the monitor, which can extend to the ability to approve contracts and transactions and to renounce other contracts. Monitors have assumed the role of the "eyes and ears of the court." They are usually, although not necessarily, licensed bankruptcy trustees.

The courts tend to be very closely guided by their views and reports. The result is that monitors have become a major factor in the reorganization process. This will not change even if the *Reform Act's* amendments to the CCAA become law.

Creditors' Committees

The CCAA does not address creditors' committees, and the *Reform Act* contains only an indirect facilitation of their role. CCAA proceedings are frequently conducted without any formal involvement of representatives of creditors, with the result that the first appearance of creditors as a group is at the meeting of creditors called upon to vote on the plan, whose direction has already been determined.

Occasionally, the court orders the formation of a creditors' committee to receive information and to interface with the debtor and/or monitor in the formulation of a plan. The *Reform Act* will provide for the possibility of creating a charge over the debtor's property in respect of certain expenses of "interested parties" in order to facilitate their effective participation in proceedings. This could result in the more active involvement of creditors' committees.

Claims Processes

The CCAA does not address the process of the filing and administration of claims. The process is usually set through an order of the court. As indicated above, the *Reform Act* would provide, for the first time, for the deferment of shareholder-related claims.

Sales of Assets and Vesting Orders

In bankruptcies, sales of assets are subject to the approval of a creditors' committee, known as inspectors. Sales usually take place pursuant to a call for public tender or other mechanism designed to obtain the best price. It is only by exception that the court becomes involved in the process.

Assets are frequently sold as part of the process of reorganization under the BIA or the CCAA. The *Reform Act* requires that any sales made out of the ordinary course of business be approved by the court, for which a number of criteria, generally relating to commercial reasonableness, are set forth. The criteria are more stringent for sales to non-arms'-length parties.

Cross-Border Proceedings

Canada was the second country, after the United States, to develop a modern reorganization culture following the adoption in 1979 of the modern form of Chapter 11 of the U.S. Bankruptcy Code. As a result, there is now a 25-year history of experience with reorganizations that cross over the U.S.-Canada border.

In 2005, the United States enacted a new Chapter 15 of the U.S. Bankruptcy Code, which largely adopts the United Nations Commission on International Trade Law ("UNCITRAL") model law for recognition of foreign insolvency proceedings. The *Reform Act* provides for similar amendments to the BIA and the CCAA.

The purpose of the UNCITRAL model law was to encourage greater cooperation between judicial systems with respect to multinational insolvencies. Cooperation already exists across the U.S.-Canada border. It is, therefore, unclear whether the statutory reforms in the United States and Canada will have any material impact on U.S.-Canada cross-border reorganizations.

However, there are two potential areas of impact. The first is with respect to corporate groups. At present, the general practise is to file proceedings in respect of a subsidiary in the country where the subsidiary is based, rather than to file the subsidiary together with the parent in the country where the parent is based. That practise may be challenged under the new laws. In addition, historically, there has been the flexibility to have a full CCAA proceeding under Canadian law, and a full Chapter 11 proceeding under U.S. law, for the same debtor. It is unclear whether the recent statutory amendments will eliminate that flexibility.

Concluding Remarks

The codification of current practice proposed by, and the major policy shifts embedded in, the *Reform Act,* are likely to be retained in whatever reform legislation is eventually passed and proclaimed into force by Canada's federal government. It is not anticipated that Canadian insolvency reform, in whatever form it takes, will significantly impair the traditional flexibility of Canada's restructuring legislation or dramatically change Canadian insolvency practice.

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Section 10 of the *Canada Interest Act* and Over Five-Year Closed Mortgage Loans: Making Sense of Outdated Legislation

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Introduction

The *Interest Act*[1] (Canada) ("Act") is federal legislation that applies across Canada. Section 10 of the Act reads as follows:

> (1) Whenever any principal money or interest secured by mortgage on real property is not, under the terms of the mortgage, payable until a time more than five years after the date of the mortgage, then, if at any time after the expiration of the five years, any person liable to pay or entitled to redeem the mortgage tenders or pays, to the person entitled to receive the money, the amount due for principal money and interest to the time of payment, as calculated under Sections 6 to 9, together with three months further interest in lieu of notice, no further interest shall be chargeable, payable or recoverable at any time thereafter on the principal money or interest due under the mortgage.
>
> (2) Nothing in this section applies to any mortgage on real property given by a joint stock company or other corporation, nor to any debenture issued by any such company or corporation, for the payment of which security has been given by way of mortgage on real property. R.S., c. I-18, s. 10

Therefore, mortgage loans beyond five (5) years, even if not prepayable, or if prepayable with yield maintenance, may be prepaid with three (3) months' interest, unless the borrower qualifies for an exemption under Section 10(2).

For income tax, capital tax and other valid considerations, holders of Canadian commercial real estate frequently structure themselves as limited partnerships or trusts. Also, real estate investment trusts represent a significant component of today's ownership segment. Yet, neither limited partnerships nor trusts qualify for the exemption in Section 10(2).

Legislative History

The legislative history of these provisions is best explained by Mr. Justice Robins of the Ontario Court of Appeal, in the frequently cited *Litowitz* decision,[2] as follows:

> The Section 10 right of prepayment was first enacted by Parliament in 1880. […]. Subsection 1, as the Parliamentary debates reveal (House of Common Debates, March 31, 1880, p. 954), was intended to remedy the problem of farmers being locked into long-term mortgages at high interest rates and being subjected to large bonuses or penalties when they sought prepayment. The exemption clause was enacted some ten years later in response to problems that s.-s. 1 had created for corporations, particularly railway companies, in obtaining long-term *financing* by way of loans secured by mortgages of real property. Lenders were understandably reluctant to provide long-term money when it was open to borrowers to repay the loan after five years even though the mortgage was closed on its terms. *Subsection 2 was added to remedy this problem and facilitate long-term commercial borrowing by exempting any mortgage "given by a joint stock company or other corporation" from the operation of s.-s. 1. As a result, the application of s.-s. 1 is restricted to non-corporate mortgagors.* [emphasis added]

As mentioned above, structurings today are frequently effected through limited partnership or trust vehicles, neither of which are corporations. When discussing this problem recently with representatives of the federal Department of Finance, the writer was asked the following question: "This problem has been around for a long time. Why all the sudden interest?" The answer lies in today's commercial real estate economic environment, in which interest rates are at historic lows, lenders possess an abundance of available funds to lend long term, and competition among buyers of quality products is so fierce that capitalization ("cap") rates are being driven down to very aggressive levels.

Therefore, for the current owner looking at refinancing it is logical to want to take advantage of low interest rates at a longer term; for the purchaser pricing the income stream at a low cap rate where the margin of error is oftentimes razor thin, longer-term stabilized debt often helps rationalize the *pro forma.*

"Longer term" today generally means longer than five (5) years; hence, the Section 10 problem. At least one major institutional lender writes 10-year commitment letters on the following basis:

> Term: 120 months, provided that the lender obtains an acceptable legal opinion that none of the borrowing entities will benefit from the right to pre-pay the loan prior to maturity pursuant to the *Interest Act,* failing which the loan will be made for a term not exceeding 5 years.

Structuring Around the Problem

Section 10(2) creates three categories of exemptions:

1. the joint stock company which, if still in existence, is rarely used, as it is a non-incorporated association with shareholders and is not nearly as regulated as a corporation itself;
2. the corporation; and
3. the debenture issued by any such company or corporation.

Being exceptions to the general rule, courts will interpret these restrictively. Also, Section 10 is of public order and, therefore, cannot be derogated from contractually. Therefore, techniques have been devised to circumvent the problem, with relative strengths and weaknesses.

Corporation as Borrower

Common Law Position

The most frequently utilized technique is to have a corporation hold legal title to the property, with the non-corporate entity (individual, limited partnership or trust) retaining the beneficial ownership.

Certain provinces, such as Ontario, have legislation similar to the Act, which has led to some interesting litigation—e.g., the 1998 decision of the Ontario Court of Appeal in the case of *Kukor Construction & Developments & Associates* v. *Canada Life Assurance Co.*,[3] where the issue of structuring via a limited partnership in the context of a mortgage loan of more than five (5) years was scrutinized. This decision is often cited as authority for the premise that a structure in which the beneficial owner of the property is a limited partnership whose general partner is a corporation (and appears on the title as such) will satisfy Section 10 of the Act. *Litowitz*[4] also concluded that prepayment was precluded under Section 18(2) of the *Mortgages Act* (Ontario)—which is substantively the same as Section 10(2) of the Act—where individual purchasers of units in a multiple-unit residential apartment building organized as a corporation that sold the units and granted the mortgage.

The Quebec Civil Law Position

In the Province of Quebec, we encounter more difficult concerns, in large part stemming from the fact that the common law distinction between legal and beneficial ownership does not exist in Quebec. While the *Quebec Civil Code* permits what are known as dismemberments of ownership (usufruct, servitude and emphyteusis), it does not divide or "fragment" ownership between legal and equitable title as does the common. Therefore, in a structure whereby a corporation acquires title to a property on behalf of another, it is doing so at what is known in the civil as a *prête-nom* or mandatary (the civil law equivalent of an agent) and the *prête-nom* has no rights of any nature whatsoever. The *prête-nom* will usually sign a *prête-nom* agreement with the owner, disclaiming any rights whatsoever and agreeing not to do anything without the owner's permission. Thus, the grantor of a conventional (i.e., contractual) hypothec (the civil law equivalent of the common law mortgage) must have the legal capacity to alienate.[5] Even if the *prête-nom* is described as the grantor of the hypothecary security, it could only be doing so on behalf of the real owner.

With this in mind, when we structure ownership of Quebec properties by way of a *prête-nom* on title on behalf of a non-corporate entity such as a limited partnership or a trust, it is really the same as if the non-corporate entity, being the true owner, had bought the property in its own right, borrowed the money on its own behalf, and hypothecated or mortgaged the property on its own behalf. Some practitioners take the view that *Kukor* and *Litowitz* are perfectly and validly applicable to Quebec, although I am aware of no case law that either supports or refutes this position.

Drop-Down

Certainly, the more conservative approach favours what is known as a "drop-down," which is used frequently in conjunction with acquisitions being financed through new mortgage financing of longer than five years. The transaction is effected in two steps: (1) purchase of the property by a corporation that owns the property outright and not as a *prête-nom* and (2) after some agreed-upon delay, transfer of the beneficial ownership to a limited partnership or trust. The legal rationale behind this is that the courts have concluded that the moment in time in which Section 10(2) is judged is the date the hypothec is granted.[6]

The drop-down works for acquisition financing, where the acquirer can plan the structure with the lender in a manner that will satisfy each party's requirements. It does not work for new financing or refinancing of a property in which the trust or the limited partnership is already the owner, unless the *Kukor* and *Litowitz* reasoning is applied and accepted. To reverse the ownership structure to a corporation is an expensive process and often carries with it adverse income tax and capital tax consequences.

Finally, even the lenders voice some concern over the drop-down. Being aware of the situation, they often wonder to themselves if this knowledge may come back to haunt them five years later. Yet, when they oblige borrowers to represent and warrant the ownership, what choice is there?

All of this just adds to the need for legislative reform.

Debenture Issuance
This technique, permitted by Section 10(2) of the Act, is accomplished by the corporation borrowing the funds and issuing a debenture for the indebtedness. The trust or limited partnership that owns the property would then guarantee the debt obligations and would secure these guarantee obligations by means of a collateral hypothec of the property.

This is a highly paper-intensive and expensive process, which most borrowers would prefer to avoid. Furthermore, since the borrower must be a corporation that issues the debenture, capital tax issues must be considered and addressed. In transactions involving multiple owners, the lenders generally will insist upon the identical process for each co-owner/borrower. Where each is not a corporation, each faces the Section 10 issue. Where one or more borrowers are corporations and qualify under Section 10(2), it would not be surprising if these other co-owners refuse to embark upon the debenture process, merely to satisfy the concerns of a co-owner structured as a limited partnership or a trust. The reasons can include internal prohibitions or restrictions upon issuing debentures, which cannot be overcome, or simply a refusal to embark upon a complicated and expensive process that is only necessary because a co-owner is not a corporation. Either explanation is perfectly legitimate in today's fast-moving commercial world.

Legislative Reform

The *status quo* and the uncertainty resulting from this situation do not serve the interests of anyone involved in the commercial mortgage lending process. Lenders anxious to "park" funds long term do not want borrowers prepaying before maturity and disturbing the yield. Borrowers want to be able to structure their ownership interests in the most advantageous manner they can create, and borrow long term without undue complication and added expense. Attorneys required to render enforceability opinions wish to do so with professional confidence. There is no reason why a borrower that is a general partnership of corporations encounters no problems under this section, while a limited partnership or trust is very problematic.

If Section 10(2) were added to the Act toward the end of the 19th Century to facilitate long-term commercial borrowings of corporations in vogue at that time, Section 10(2) would very easily be amended by adding limited partnership and trusts to the permitted exemptions. This would easily solve the problem, and put an end to all of the uncertainty and complications discussed above.

Discussions have been held with the federal Department of Finance to amend Section 10(2). A preliminary meeting was held in Ottawa in June 2006, and the submissions received a positive reaction. The process will now continue in full force and, hopefully, Section 10(2) will be amended in the near future to add limited partnerships and trusts to the list of permitted exceptions.

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[1]1985 R.S., c.1-18.
[2]*Litowitz* v. *Standard Life Assurance Co. (Trustees of)* (1996), 30 O.R. (3d) 579, [1996] O.J. No. 3816 (Ont. C.A.), motion for permission to appeal to the Supreme Court of Canada denied.
[3]11 O.R. (3d) 577
[4]Op. cit,, note 3
[5]Article 2681 of the Civil Code of Quebec: "A conventional hypothec may be granted only by a person having the capacity to alienate the property hypothecated."
[6]See, for example, *Laberge* v. *Caisse de depôt et placement du Québec,* [1998] R.J.Q. 1956, where individuals assuming a mortgage debt that had originally been granted by a corporation could not then use Section 10(1) to prepay the debt after five years.

Canadian Division Report on Legislative and Judicial Developments

I. GOVERNMENT RELATIONS GENERALLY

A. Parking Tax

British Columbia

Efforts continue to fight against the parking tax this Fall as the legislators return to work. While the Parking Tax has been implemented, ICSC, led by Ted Williams of Ivanhoe Cambridge, has been successful in persuading Translink, the beneficiary of the tax, to conclude that the current Vancouver parking tax is an ineffective and inappropriate method of financing the Translink effort to build a RAV mass transportation line. Translink, which itself is under review, has adopted a resolution to terminate the task as soon as alternate funding becomes available. Efforts will now be focused on moving the government toward finding a more appropriate source of funding for RAV.

B. Canada Interest Act

Fred Carsley of De Grandpre Chait is working with Capital Hill Group to lobby the Federal Government to adopt changes to the Interest Act (Canada) to better facilitate longer-term mortgage financing in the Province of Quebec for non-corporate entities. Meetings with Finance Canada have recently taken place, and there appears to be progress on this matter.

II. TORONTO ACT – Sabrina A. Gherbaz, Torys LLP

On June 12, 2006, Bill 53, the *Stronger City of Toronto for a Stronger Ontario Act* received Royal Assent and came into force (excluding the schedules). The *Stronger City of Toronto for a Stronger Ontario Act* contains three schedules—a new City of Toronto Act; amendments and repeals of certain public acts respecting municipal matters; and repeals of certain private acts relating to the City of Toronto. Each of the schedules (or part thereof) comes into force on the date named in a proclamation by the Lieutenant Governor.

The most substantive and important part of the *Stronger City of Toronto for a Stronger Ontario Act* is the schedule relating to the new *City of Toronto Act, 2006* (the "Act"). This legislative summary focuses on the Act.

The Act has not yet been proclaimed into force. Once the Act is proclaimed into force, the Act will replace the *City of Toronto Act, 1997 (No.1)* and *City of Toronto Act, 1997 (No.2)* (collectively, the "Prior Acts"). The purpose of the Act is to provide the City with greater powers, accountability and responsibility than previously afforded to the City under the Prior Acts, and under the various other public and private acts relating to the City. According to the preamble of the Act, broadening the City's powers, accountability and responsibility will assist the City in building "a strong, vibrant and sustainable city that is capable of thriving in the global economy."

The Act includes provisions similar (but not identical) to those included in the *Municipal Act,* 2001, and, as a result thereof, the *Municipal Act,* 2001, except in certain specified circumstances, will no longer apply to the City or any of its local boards or corporations; members of City Council, the City's local boards or its corporations; directors of the City's corporations; and its officers, employees and agents of the City, its boards and its corporations.

For the shopping centre industry, the most notable features of the Act are the City's express authority to:

a) provide for a system of licences with respect to a business carried on within the City;
b) impose direct taxes;
c) require retail business establishments (other than prescribed retail business establishments and retail business establishments offering goods or services for sale in connection with prepared meals or living accommodations) to be closed to the public at any time;
d) prohibit the demolition of residential rental properties containing six (6) or more units, and to prohibit the conversion of residential rental properties containing six (6) or more units to a use other than a residential rental property; and
e) pass a by-law requiring and governing the construction of "green roofs" if the provisions of the by-law do not conflict with the provisions of a regulation made under *the Building Code Act,* 1992, respecting public health and safety, fire protection, structural sufficiency, conservation and environmental protection, and the requirements respecting barrier-free access.

The powers described in (a) and (b) above are described in greater detail below.

Under the Municipal Act, 2001, a municipality is only authorized to provide for a system of licences with respect to a business wholly or partly carried on within the City (even if the business is being carried on from a location outside the City) *for purposes of* health and safety, nuisance control, and consumer protection. Under the Act, the City may provide for a system of licences with respect to any business wholly or partly carried on within the City for any purpose whatsoever. However,

the Act provides that the Minister of Municipal Affairs and Housing may make regulations exempting any business from all or part of a by-law providing for a system of licences with respect to a business, impose conditions and limitations on the City's powers under the Act to provide for a system of licences with respect to a business, and prohibit the City from imposing on any business in respect of which a provincial certificate has been issued, a condition or licence requiring testing, on the subject matter of the certification.

In addition to the City's right to impose traditional municipal taxes and charges and fees for services provided and for property use, the Act permits the City to impose a tax in Toronto if the tax is a direct tax. However, the Act contains a limited list of direct taxes which the City is not permitted to impose. The list of direct taxes which the City is not permitted to impose includes:

a) a tax in respect of a person's income, revenue, profits, receipts, paid-up capital, reserves, earned surplus, capital surplus or wealth;
b) a tax in respect of machinery and equipment used in research and development or manufacturing and processing;
c) subject to certain express exceptions, a sales tax imposed on a person in respect of the acquisition or purchase of any tangible personal property, any service, or any intangible property;
d) a lodging/hotel-use tax;
e) a poll tax; and
f) a highway-use tax.

By way of example, the City could impose a parking lot and garage tax, a commercial concentration tax and a real property registration tax (such as a transfer or mortgage registration tax). The Act provides that the Lieutenant Governor in Council may impose restrictions on the City's right to levy a direct tax in the City of Toronto.

III. PROVINCIAL REPORTS

1) British Columbia

a) Legislative Developments - Randy Klarenbach, Richards Buell Sutton LLP

For the Spring 2006 session of the B.C. Legislature, a summary of some relevant legislation is set out below.

EMPLOYMENT STANDARDS (COMPASSIONATE CARE LEAVE) AMENDMENT ACT, 2006, S.B.C. 2006, C. 4 (BILL 8)
Summary: Bill 8 amends the *Employment Standards Act to add a provision providing for compassionate care leave. The Act currently provides for job protection for jury duty and* pregnancy, parental, family responsibility and bereavement leaves. Compassionate care leave is a new addition.

Bill 8 permits an employee to take up to eight weeks of unpaid leave in order to care for a family member who is at a significant risk of death within 26 weeks or other time period as prescribed by future regulation. This risk of death must be certified by a medical practitioner with the issuance of a medical certificate. The employee must give the employer a copy of this medical certificate. If that family member does not die within that 26 weeks or other prescribed period, the employee may take a further unpaid leave after obtaining a new medical certificate. "Family member" is defined as a member of the employee's immediate family or a person defined as such by future regulation.

In Force: Act in force April 27, 2006 (B.C. Reg. 97/2006)

MISCELLANEOUS STATUTES AMENDMENT ACT (No. 2), 2006. S.B.C. 2006, C. 24 (BILL 30)
Summary: Bill 30 amends 9 statutes, including:

Land Act, including to:

provide for the submission of plans in electronic format and the certification of subscribers to sign and transmit those plans to the Surveyor General;

Land Survey Act, including to:

permit the Surveyor General to require and specify standards for the electronic submission of field notes and other survey data;

Land Surveyors Act, including to:

clarify that the Association of British Columbia Land Surveyors may make rules for plans, including plans in electronic format;

Land Title Act, including changes to reflect electronic applications.

In Force: Sections 1 to 8, 10 to 18 and 48 to 54 in force May 18, 2006. Section 9 in force, Jan. 1, 2007. Section 19 in force Jan. 20, 2005. Section 47 in force Sept. 4, 2006 (B.C. Reg. 211/2006)

MISCELLANEOUS STATUTES AMENDMENT ACT, 2006, S.B.C. 2006, C. 15 (BILL 15)
Summary: Bill 15 amends 13 statutes, including:

Employee Investment Act, including to:
require corporate governance plan to be in place within an employee venture capital plan;
provide protection from legal liability for government employees or persons appointed under the Act unless those persons acted in bad faith;
Greater Vancouver Transportation Authority Act, including to:
authorize the Lieutenant Governor in Council to exempt, by order, persons from liability for taxation under specified statutes for land or improvements that the person acquires or uses for certain projects, and that are described or are of the type characterized in the order;
Human Resource Facility Act, including to:
authorize the minister to provide grants and other financial assistance to persons who conduct research related to a human resource purpose or provide administrative support services to a human resource operator;
Protected Areas of British Columbia Act, including to:
add descriptions *for specified new parks and ecological reserves;*
amend and repeal descriptions for specified parks;
Transportation Act, including to:
permit the minister to exercise powers related to an improvement or other work of public utility, whether or not the purpose relates to transportation;
protect employees and agents of the government from legal liability, and specifies the sections under which persons may be authorized to commit acts or omissions that may lead to loss or damage;

In Force: Sections 1 to 12, 14 to 27, 30 to 32, 33(b) to (d), 34 to 42 and 44 to 47 in force March 30, 2006. Sections 13 and 48 in force March 30, 2005. Section 43 in force Dec. 31, 2004. Sections 28 and 29 in force June 14, 2006 (B.C. Reg. 167/2006). Section 33(e) in force June 23, 2006 (B.C. Reg. 186/2006)

SAFETY STANDARDS AMENDMENT ACT, 2006, S.B.C. 2006, C. 31 (BILL 25)
Bill 25 proposes an amendment to the Safety Standards Act. This amendment will help local authorities target and shut down marijuana-growing operations more quickly and more efficiently.

Bill 25 amends the:
Safety Standards Act, including to:
add a new Division 3 (Residential Electricity Information) permitting local governments to obtain electricity consumption information from electricity distributors, and to share that information with administrators of the Act and with the police;
authorize service of notices and documents to addresses obtained under the new Part 3 for the purposes of a safety officer's right to enter and inspect residence under the Act;
require the owner or occupier who receives such a notice to permit the safety inspector to enter the residence.
In Force: Act in force June 23, 2006 (B.C. Reg. 190/2006)

SMALL BUSINESS AND REVENUE STATUTES AMENDMENT ACT, 2006, S.B.C. 2006, C. 17 (BILL 14)
Summary: Bill 14 amends 8 statutes, including:

Assessment Act, including to:
permit the assessment roll to be revised if improvements on land are substantially damaged or destroyed after Oct. 31 and before the next Jan. 1;
provide that, for property that is substantially damaged or destroyed after Oct. 31 and before the next Jan. 1, that the valuation of the property is based on the physical condition of the property on Dec. 31 following the valuation date and not Oct. 31;
Greater Vancouver Transportation Authority Act, including to:
permit the parking site roll to be revised if land or improvements that are a parking site are substantially damaged or destroyed after Oct. 31 and before the next Jan. 1;
Tobacco Tax Act to:
specify that only authorized dealers or persons in the business of transporting goods for the public under contract from an authorized dealer may transport tobacco in bulk quantities.
In Force: *Section 4 retroactively on Jan. 1, 2001. Section 12 retroactively on* Dec. 31, 2004. Sections 5 to 11 and §§ 13 to 14 in force on Royal Assent March 30, 2006.

TOBACCO SALES (PREVENTING YOUTH ACCESS TO TOBACCO) AMENDMENT ACT, 2006, S.B.C. 2006, C. 10 (BILL 12)

Amended: *Tobacco Sales Act*, R.S.B.C. 1996, c. 451. Consequential amendments are made to the *Tobacco Tax Act*, R.S.B.C. 1996, c. 452

Summary: Bill 9 amends the *Tobacco Sales Act*, including to:

oblige tobacco vendors to verify age for anyone appearing to be under the age of 25 years, and prohibit vendors from selling tobacco to anyone producing identification that appears to have been altered;

add the power to keep seized material to investigate a contravention or impose an administrative penalty;

permit the administrator to delegate functions, duties and powers under the Act.

In Force: By regulation

SUMMARIES FALL 2005 SESSION

For the Fall 2005 session of the BC Legislature, a summary of some legislation is set out below.

CIVIL FORFEITURE ACT, S.B.C. 2005, C. 29 (BILL 13)

Summary: Bill 13 provides that, after a B.C. Supreme Court order is issued, cash or real or personal property acquired from an unlawful activity is forfeited to the government for use by the government and/or victims of crime. Bill 13 also provides for: interim preservation orders, protection orders and other related orders.

Findings of fact in proceedings under Bill 13 are to be made on the balance of probabilities, not on the criminal standard of proof beyond a reasonable doubt. Bill 13 provides that an unlawful activity may be found to have occurred even if no person has been charged with an offence that constitutes the unlawful activity or a person charged with an offence that constitutes the unlawful activity was acquitted of all charges in proceedings before a criminal court or the charges are withdrawn or stayed or otherwise do not proceed.

Bill 13 also contains a reverse onus provision that requires a person to prove that property seized by the government was not proceeds of unlawful activity.

Unlike its predecessor, Bill 5, which had no limitation period, Bill 13 provides that the time limit for commencing an action or originating application is 10 years from the date on which the unlawful activity occurred.

Bill 13 provides that the Supreme Court, if it determines that the forfeiture of property or the whole or a portion of an interest in property is not in the interests of justice, may refuse to issue a forfeiture order, limit its application or put conditions on the forfeiture order.

Bill 13 is to be regulated by a director who will administer Bill 13, including to: arrange for proceedings under the Act and distribute forfeited property.

Notices that proceedings are commenced may be filed by the director in the Land Title Office. Lien provisions under the *Personal Property Security Act* apply subject to Bill 13. The director may make payments arising out of forfeited property for one or more of the following purposes: the administration of the Act; the compensation of eligible victims; the prevention of unlawful activities; remediation of the effect of unlawful activities and other prescribed purposes.

In Force: Act is in force April 20, 2006 (B.C. Reg. 89/2006)

GREATER VANCOUVER TRANSPORTATION AUTHORITY AMENDMENT ACT, 2005, S.B.C. 2005, C. 32 (BILL 9)

Summary: Bill 9 amends the *Greater Vancouver Transportation Authority Act*, including to:

require municipalities and the Surveyor of Taxes to collect and pay parking tax in the same manner that they have to collect and pay authority levied property tax;

permit municipalities and the Surveyor of Taxes to collect a prescribed administration fee as compensation for collecting and paying parking tax;

apply to parking tax the same notice requirements and the same taxation statute provisions that apply to authority-levied property taxes;

permit the authority to assess parking tax;

permit the authority to inspect land, improvements and records regarding the parking tax;

regulate complaints and appeals;

permit regulations to be made; and

require a review by government of the parking site tax within 10 years.

In Force: Act, except Sections 29(3), 38, 43, 47 to 50, 92, 120 and 121, come into force by regulation. Section 29 (3) comes into force on Oct. 1, 2001. Sections 38, 43, 47 to 50, 92, 120 and 121 come into force on March 31, 1999, or on an earlier date set by regulation. Act is in force Dec. 6, 2005 (B.C. Reg. 347/2005)

MISCELLANEOUS STATUTES AMENDMENT ACT (No. 2), 2005, S.B.C. 2005, C. 35 (BILL 16)
Summary: Bill 16 amends 13 statutes, including:
Business Number Act, including to:

permit the minister to require a business entity to provide business information in order to verify the identity of that business regarding the use by the business of an electronic identifier to be used to access services provided by a public body;

Business Practices and Consumer Protection Act, including to:

permit the Lieutenant Governor in Council to designate, by regulation, a business, industry, trade, profession, occupation or employment;

require a person engaging in a designated activity to have a licence, unless the person is otherwise exempted by regulation;

prohibit the Lieutenant Governor in Council from designating activities to which specified statutes apply, including the *Legal Profession Act.*

In Force: *Sections* 5 to 21, 26, 28 to 31, 33 to 42 in force on Royal Assent Nov. 24, 2006. Sections 21 and 26 in force Jan. 17, 2005. Sections 5 to 20, 28 to 31 and 33 to 42 in force Nov. 24, 2005. Sections 1 and 2 in force Dec. 13, 2005 (B.C. Reg. 364/2005). Sections 22 to 25 in force April 1, 2006 (B.C. Reg. 3/2006). Section 32 respecting the repeal of Sunnybrae Park, in force March 28, 2006 (B.C. Reg. 60/2006)

2) Alberta

a) Legislative Developments – Murray Tait, T&T Properties

There are no updates at the time of writing.

b) Case Law

There are no updates at the time of writing.

3) Saskatchewan

a) Legislative Developments

There are no updates at the time of writing.

b) Case Law

There are no updates at the time of writing.

4) Manitoba

a) Legislative Developments

There are no updates at the time of writing.

b) Case Law Developments

There are no updates at the time of writing.

5) Ontario

a) Legislative Developments – Stephen Messinger, Minden Gross Grafstein LLP

Recent Ontario Legislation

1. Bill 126 – *Job Protection Commissioner Act*
   The Bill underwent a First Reading on June 8, 2006.

The Bill creates the office of Job Protection Commissioner for the purpose of seeking to enhance the competitiveness and effectiveness of business enterprises and of Ontario's economy in general, seeking to prevent workplace closures and resulting job losses, and seeking to mitigate the effects of job losses. The Job Protection Commissioner would carry out these objectives in a variety of ways, including conferring with business enterprises and employee groups, promoting the development of economic plans, making policy recommendations to various levels of government and providing mediation services.

2. Bill 127 – *Employment Standards Amendment Act*
   The Bill underwent a First Reading on June 8, 2006.
   The Bill makes several amendments to the *Employment Standards Act, 2000.*

Subsection 58 (1) of the Act requires an employer who terminates the employment of 50 or more employees in the same four-week period to give notice of termination "for the prescribed period." The Bill provides for increased notice periods (16, 20 and 24 weeks, respectively), building them into the Act itself, and adds the requirement of a mass layoff agreement between labour and management, dealing with such matters as retraining and restructuring options. If no mass layoff agreement is reached, a uniform 52-week notice period applies

instead. The Bill also reduces the qualifying period for severance pay of employment to one year and the payroll level to $1 million. The Bill increases severance pay to two weeks' pay for each year of employment. Subsection 65 (5) of the Act, which caps severance pay at a 26-week maximum, is repealed.

Status of Bills (Ontario) Previously Reported

1. Bill 51 – *Planning and Conservation Land Statute Law Amendment Act*

The Second Reading was carried out on April 26, 2006. The Bill was referred to the Standing Committee on General Government, and considered on Aug. 3. 2006.

The Bill proposes to make numerous amendments to the *Planning Act.* Most of these would modify aspects of the land use planning process, provide additional tools for implementation of provincial policies, and give further support to sustainable development, intensification and Brownfield redevelopment.

2. Bill 53 – *Stronger City of Toronto for a Stronger Ontario Act*

The Third Reading was carried on division June 12, 2006. The Bill received Royal Assent June 12, 2006.

The Bill enacts the *City of Toronto Act*, 2006, which is set out in Schedule A. The Bill also amends various public Acts in respect of municipal matters, and those amendments are set out in Schedule B.

A new § 62.1 of the *Liquor Licence Act* authorizes the City of Toronto to pass by-laws extending the hours of sale of liquor by licence holders in all or part of the City. A city by-law prevails over a regulation made under the Act. Subsection 6 (2) of the Act is amended to provide that an applicant for a licence to sell liquor is not entitled to the licence if the applicant is carrying on activities that contravene such a city by-law.

3. Bill 95 – *Employment Statute Law Amendment Act (Informing Students of their Employment Rights)*

The Second Reading was debated and carried on division May 10, 2006. The Bill has been referred to the Standing Committee on Regulations and Private Bills. The Bill amends the *Employment Standards Act, 2000,* and the *Occupational Health and Safety Act,* to require employers to give their student employees specified information about both Acts by posting a poster in workplaces and providing copies of a booklet.

4. Bill 119 – *Employment Standards Amendment Act (Wage Security)*

The Bill underwent a First Reading on May 31, 2006. The Bill amends the *Employment Standards Act, 2000,* by adding Part XV.1, which establishes the Employee Wage Security Program and provides for the appointment of a Program Administrator. Under the Program, employees will be eligible for compensation for certain types of unpaid wages.

5. Bill 120 – *Fire Protection Statute Law Amendment Act*

The Second Reading was debated and carried on division June 8, 2006. The Bill was referred to the Standing Committee on General Government. The referral was discharged, and the Bill was then referred to the Standing Committee on Regulations and Private Bills on June 22, 2006. The Bill amends the *Building Code Act, 1992* and the *Fire Protection and Prevention Act, 1997,* to provide that regulations made under each of those Acts, known, respectively, as the Building Code and the Fire Code, ensure that every fire escape is constructed of non-combustible material.

Update on Assessment Board Review and Ontario Municipal Board Hearings

Ontario is conducting assessment review board hearings for various shopping centres in the Province of Ontario. A chart is available illustrating the dates from August 2006 through December 2006 on which hearings will be held for specific centres.

b) Case Law Developments - Joseph Grignano & Gasper Galati, Daoust Vukovich LLP

473807 Ontario Ltd. v. *TDL Group Ltd. [2006] O.J. No. 3050 (Ontario Court of Appeal, July 27, 2006, J.I. Laskin, M. Rosenberg and H.S. LaForme JJ.A.)*

This case involved an appeal of a lower Court decision that was reported to the ICSC's Canadian Division Committee on June 7, 2005.

At trial, the tenant obtained judgment against the landlord in the amount of approximately $700,000.00. The judgment order entitled the tenant to set off the full amount of the award against the rent payable by the tenant under the lease. Shortly after the initial trial, the landlord defaulted under its mortgage and, as a result, the mortgagee/lender entered into possession. The mortgagee sought to collect rent from the tenant, but the tenant refused to pay on the basis that it was entitled to withhold rent until the full amount of the judgment was satisfied. The tenant and mortgagee had executed a postponement and non-disturbance agreement ("PDNA") at the time the lease was entered into, but the PDNA was silent as to the issue of the tenant's rights of set-off.

The mortgagee applied to the court for a determination of the parties' rights. The lower court ruled that the tenant could not apply its court-ordered set-off against rent. The court ruled that the state of accounts that existed between the tenant and its landlord could only bind the mortgagee if the PDNA included language to this effect. The

court also found that the mortgagee was not bound by the set-off because it was not a party to the litigation between the tenant and the landlord. The tenant appealed.

The Court of Appeal overturned the lower court decision, and ruled that the mortgagee was bound by the state of accounts between the landlord and tenant, including the set-off. The tenant was allowed to enjoy the offset and remain in possession. The decision turned on the interpretation of the PNDA. The court believed that it was the intention of the parties that if the mortgagee took possession, it would take over the landlord's position and the tenant's position would not change. Thus, since the mortgagee agreed to accept the landlord's obligations, these obligations included the court-ordered set-off. The court emphasized a clause in the PNDA stating that the mortgagee would not be liable for any rent that was prepaid to the landlord. The court interpreted this to mean that the parties did not intend to exempt any other items.

The Court of Appeal went on to disagree that a new lease came into effect when the mortgagee went into possession. It found this to be inconsistent with the words of the PNDA. The mortgagee agreed to be bound as landlord under the "lease"; there was no new lease, but merely a "stepping into the shoes" of the landlord by the mortgagee under the existing lease. In the court's view, this situation was akin to an assignment, in which an assignee inherits whatever equities exist at the time.

The court recognized that both the tenant and mortgagee were innocent parties, and neither could have anticipated the landlord's actions. It nevertheless looked to the contract to determine who would suffer the loss. (Notably, the court did not analyze unequal bargaining power faced by the mortgagee against a strong tenant whose lease was prior to the mortgage.) The mortgagee agreed to assume the risk under the PNDA; it could have protected itself and declined to do so. The court noted that in PNDAs favourable to mortgagees, it was common commercial practice to exclude set-off rights. The mortgagee did not exclude the right to set-off in the PNDA.

With respect to the lower court ruling to the effect that the mortgagee was also not bound by the set-off as it was not a party to the original litigation between the tenant and the landlord, the Court of Appeal ruled that the mortgagee did not have to be a party to the original litigation between the landlord and the tenant for the judgment to be binding on the mortgagee. In the court's view, it was not the litigation that affected the mortgage but, rather, the PNDA alone determined the mortgagee's obligations. In other words, the mortgagee's responsibility for the lower court judgment depended solely on the terms of the PDNA. In this case, the PDNA bound the mortgagee to accept the state of accounts between the landlord and the tenant. The court also noted that the mortgagee did have notice of the tenant's litigation but opted not to intervene.

O Mei Restaurant v. *Fontana Development Ltd. [2006] O.J. No. 2807 (Ontario Superior Court of Justice, July 11, 2006, K.A. Hoilett J.)*

The parties to this dispute entered into a 20- year lease. The lease contained an "entire agreement" clause, making the contents of the lease not subject to change unless the amendment was consented to in writing and signed by the tenant and *two* representatives of the landlord. The lease was subject to eleven (11) amendments in the form of "tenant assistance agreements," each lowering the amount of rent payable by the tenant. Each tenant assistance agreement provided that the landlord was entitled to terminate the lease on thirty (30) days' prior written notice if it received a *bona fide* third party offer to lease. After receiving what the landlord considered to be a *bona fide* third party offer to lease, the landlord sent a notice of termination to the tenant. Prior to receiving the notice of termination, the tenant spent a considerable amount of money to renovate its premises.

The tenant sought an interim injunction to enjoin the landlord from terminating the lease. The tenant argued that it would be inequitable for the landlord to terminate the lease, as the landlord was well aware that the tenant planned a renovation for its premises but had not advised the tenant beforehand that it was considering terminating the lease. The tenant also contended that the landlord's termination right was invalid, as changes to the lease required the signature of the tenant and two representatives of the landlord. In this case, each of the tenant assistance agreements had only been signed by one representative of the landlord.

The court granted the injunction. The court was satisfied that the tenant met the three-part test for the granting of interim injunctions, namely: (1) there was a serious issue to be tried; (2) the party seeking the injunction ran the risk of irreparable harm if the injunction was not granted; and (3) the balance of convenience favoured the party seeking the injunction.

With respect to the first part of the test, even though the court noted the weaknesses in the tenant's arguments (namely, that the tenant enjoyed the benefit of the tenant assistance agreements for years, but was now challenging their validity), it ultimately decided that the tenant's arguments should proceed. The court was also of the view that the tenant would suffer irreparable harm if the injunction was not granted. In this regard, the court took into account the loss of the tenant's recent renovations as well as the loss of the intangible assets associated with the tenant's long-term operation. With respect to the balance of convenience, the court noted that the inconvenience associated with a forced dislocation of a long-established business was self-evident; the landlord would not be seriously prejudiced, as the tenant would continue to pay rent.

Omers Realty Corp. v. *Sears Canada Inc. [2006] O.J. No. 1981 (Ontario Court of Appeal, May 19, 2006, K.N. Feldman, R.P. Armstrong and J.L. MacFarland JJ.A)*
This case involved an appeal of a lower court decision, which was reported to the ICSC's Canadian Division Committee on June 7, 2005.

At trial, the landlord appealed the ruling of an arbitration board dealing with the recovery of "shortfall" realty taxes by the landlord. In particular, the lower court proceeding dealt with the interpretation of amendments to the *Municipal Act* in 1998, which capped the amount of realty taxes billable to tenants, despite lease provisions, and allowed landlords to recover any shortfall from other tenants. The shortfall resulted from the amount that previously had been collected under the lease, but no longer could be because of legislative caps. Landlords were permitted to recover this from two classes of tenant: one whose pre-Dec. 31, 1997, leases provided for tax payments that did not reach the legislative cap threshold (protected tenants not at cap) and the other whose tenancies commenced between Jan. 1 and Dec. 17, 1998 (uncapped shortfall tenants). Tenants who entered leases after Dec. 17, 1998, were neither subject to a cap nor liable to pay any portion of any shortfall.

At Stone Road Mall in Guelph, Ontario, Sears was a protected tenant not at cap. It was allocated a significant share of shortfall. The landlord maintained that it had discretion under the legislation to select, from its protected tenants not at cap and from its uncapped shortfall tenants, who should contribute to shortfall. The landlord also absorbed some of the shortfall itself. Sears objected to the landlord's allocation of shortfall, and invoked the arbitration clause in the lease. The arbitrators ruled that despite the permissive wording of the operative legislative provision: "A landlord may require a tenant to pay an amount on account of taxes … that is more than the tenant would otherwise be required to pay under the tenant's lease," some of the shortfall must be assigned to all shortfall tenants, whether capped or uncapped, and the only discretion residing in the landlord was as to how to allocate amongst all shortfall tenants for purposes of achieving an equitable and reasonable treatment. The landlord appealed the ruling of the arbitrators.

The lower court overturned the decision of the arbitrators, ruling that the landlord could allocate shortfalls as it saw fit. The tenant subsequently appealed. The Court of Appeal upheld the result of lower court's decision, but it arrived at its decision on grounds which differed from that of the lower court. In the Court of Appeal's view, the matter at hand was an issue of statutory interpretation. The legislation set out the maximum amount the landlord was entitled to recover and the group of tenants from whom the landlord could collect the shortfall. The legislation did not include language that required a landlord to allocate shortfalls among all tenants within the eligible group. At the same time, however, the landlord could not act arbitrarily in allocating shortfalls to tenants, unless the statute expressly permitted the landlord to do so. Accordingly, the Court of Appeal held that the landlord did indeed have the right to determine which of the eligible tenants would bear the shortfall, so long as it did not act arbitrarily. The Court of Appeal was satisfied that the landlord had advanced compelling reasons for employing the methodology it did; its decision could be rationally supported and, therefore, it was not patently arbitrary or unreasonable.

6) Quebec – Fred Carsley, De Grandpré Chait

a) Government Relations matters

Canada Interest Act

Historically low interest rates and an abundance of available permanent mortgage money from institutional lenders has resulted in owners of commercial properties borrowing longer term. This, coupled with modern structuring techniques such as limited partnerships and trusts, frequently brings into play §10 of the *Canada Interest Act* ("Act").

The issues apply throughout Canada, as the Act is federal, but are more pronounced in the Province of Quebec. This is principally caused by the legal fact that unlike the Common Law, Quebec Civil Law does not distinguish between legal and beneficial ownership. Since §10 (1) of the Act permits pre-payment after five (5) years with a penalty that cannot exceed the equivalent of three (3) months' interest, and since §10 (2) exempts corporations and joint stock companies, but does not exempt partnerships and trusts. Certainly in Quebec, this becomes a challenging and expensive adventure for both lenders and borrowers alike.

ICSC, led by Fred Carsley, is working to correct this problem.

b) Case Law

Court of Appeal

Investissement 299 Sir Wilfrid Laurier Ltée c. Trust Général du Canada (C.A. Montréal, Jan. 30, 2006), 2006 QCCA 97, SOQUIJ AZ-50353472, J.E. 2006-321

In 1987, the landlord leased shopping centre premises to Trust Général du Canada ("Trust") for a ten-year period. Most of the services offered at this branch consisted of long-term financial advice (planning, investments, estates, etc.). Over- the-counter transactional operations represented approximately only 20% of its activities.

In 1993, the Trust was acquired and succeeded by Banque Nationale du Canada ("BNC"). BNC moved the Trust services to another nearby branch, and installed its hypothecary loans development centre in the premises as well as an ATM permitting only withdrawals. The lease, in addition to containing the usual continuous operation clause, allowed *and* required that the tenant conduct "the operations normally conducted by a trust."

Arguing that this clause had been breached by the tenant, the landlord claimed a $1,250.00 per day penalty for the period running from the use change to the termination of the lease.

The Court of Appeal first noted that the lease did not include a specific definition of the permitted/prescribed operations. Moreover, the landlord did not provide any evidence in court to that effect, thereby depriving both the court and the tenant of an objective standard by which to assess whether the premises were being used in accordance with the lease.

The court also ruled that, according to the lease, it was the general business of the tenant, which was to be operated in a continuous manner until the end of the lease, and not necessarily all the specific activities that were conducted by him at the inset of the lease.

The landlord argued that the parties' intention was for the business to be operated in the premises as a "traditional banking branch" providing transactional services. This argument was rebutted upon evidence showing that even during the occupation of the premises by the Trust, only 20% of its activities were of a "transactional" nature. The court, therefore, concluded that "by operating a hypothecary loans development centre in the leased premises, BNC did in fact pursue, in a continuous manner, the principal activity of the Trust while maintaining a minimum of transactional banking services through an ATM allowing withdrawals."

Superior Court

Métro Richelieu Inc. c. Corporation First Capital Wilderton Inc. (C.S. Montréal, Oct. 26, 2005), SOQUIJ AZ-50348572, J.E. 2006-425

Supermarket Métro and pharmacy Pharmaprix were tenants in two shopping centres managed by the landlord. The Métro leases contained exclusivity clauses whereby the landlord could not allow or tolerate the competing sale or distribution of food products in the shopping centres, with the exception of pharmacies, which could devote up to 6% of their GLA to the storage, display or sale of food products.

In the leases binding it to the landlord, Pharmaprix acknowledged the exclusivity clause (which constituted a stipulation for another) and, therefore, could not ignore its existence. However, evidence showed that the areas for storage, display and sale of food products amounted to approximately 21% in each of the two pharmacies.

Accordingly, the court granted a permanent injunction in Métro's favour. The court also granted Métro the right to access Pharmaprix's premises to take photos, measurements and monitor its overall compliance with the said injunction.

c) Environmental Matters

The Rona controversy

In April 2006, Rona began the construction of a distribution centre in the middle of Terrebonne, Québec's wetlands. As a consequence, the hardware giant may soon be faced with a penalty approaching $2 million. In fact, Rona never obtained the necessary governmental authorizations in order to build on the inconstructible lands in Terrebonne.

In the opinion of the Ministère du Développement durable, de l'Environnement et des Parcs (Ministry of Sustainable Development, Environment and Parks, MDDEP), the strategy of many companies consists of first destroying the wetlands and beginning construction without obtaining the proper authorizations. If it is subsequently noticed that construction is being done on inconstructible land, the companies in violation will then have to pay penalties and request the necessary authorizations. However, these companies will still end up turning a profit. With this technique, companies like Rona are able to purchase land for very low price, as wetlands have no economic value.

The MDDEP has announced that it will unveil its new policy to protect Québec's wetlands in autumn of 2006. The ultimate goal is to prohibit construction on wetlands. If in some cases this becomes impossible, a system of just compensation will be implemented.

As is currently stands, entrepreneurs prefer to begin construction on inconstructible lands and wait for possible penalties, instead of making all the necessary requests for authorization required by the municipal, provincial and federal governments.

7) New Brunswick – Andy Lodge, Barry Spalding Lawyers – Avocats

The only legislative development that has occurred in New Brunswick since our last report was the further raising of the minimum wage. Effective July 1, 2006, the minimum wage in New Brunswick has been increased to $6.70 per hour. In addition, although it could be retracted, it is worthy to note that Post-Secondary Education and Training Minister Jody Carr have already asked the Minimum Wage Board to consider incremental increases to raise the minimum wage level to $7.10 per hour by July 1, 2007. Of course, we must bear in mind that New Brunswick is in the midst of a provincial election; thus, any detailed analysis of the future plans of our provincial government will have to wait until we see who will be in power.

The only other development of interest was the introduction of Bill 6 Franchises Act into the Legislature for a first read on Dec. 7, 2005. It was referred to the Law Amendments Committee prior to a second reading but died on the table when the election was called.

With respect to judicial developments, there were no notable cases relevant to this group.

8) Nova Scotia – Alanna D. Robinson, Wickwire Holm

Retail Business Uniform Closing Day Act

As of June 28 and June 30, 2006, amendments were made to the *Retail Business Uniform Closing Day Regulations* (the "Regulations"). The amendments clarify an exemption in the Regulations that allow grocery stores less than 4,000 square feet (sf) to open on Sundays. Under the amended regulations, the entire building must be less than 4,000 sf, even if the grocery stores operate as multiple businesses under one roof.

Section 3 of the *Retail Business Uniform Closing Day Act (the "Act")* allows certain businesses such as movie stores and laundromats to remain open on Sundays.

The *Regulations* state that §3 of the Act does not apply to a store whose principal business is selling groceries, and that at no time operates a retail sales area greater than 4,000 sf. The Regulations also state that two or more stores that are owned, occupies or operated by related persons are deemed to be one store if they are in the same building or adjacent, or in close proximity to each other.

The amendments do not affect grocery retailers that are regularly opened on Sundays before June 1, 2006.

The Atlantic Superstore and Sobeys Inc. began opening their stores on Sundays in the summer of 2006. The government stated that the large grocery chains were violating the results plebiscite of 2004 where Sunday shopping was not approved.

Sobeys Inc. has filed an application in the Supreme Court of Nova Scotia to have the amended regulations declared invalid. Sobeys Inc. subdivided some of its stores in June 2006 in an attempt to comply with the regulations so that it may open on Sundays. Peter's Frootique introduced the strategy of subdividing stores. In 1999, a court declared that Pete's Frootique was not violating the Act. Pete's Frootique was not affected by the changes in the regulations, since its stores were opening on Sundays before the June 1 deadline. No decision in the Sobeys case has been rendered.

It has been suggested that Nova Scotians will have another opportunity to vote on Sunday shopping during a plebiscite coinciding with municipal elections scheduled for 2008.

9) Prince Edward Island – Donald MacKenzie, Foster Hennessey MacKenzie

a) Legislative Developments

Nothing to report

b) Case Law Developments

Nothing to report.

10) Newfoundland and Labrador – Robert B. Andrews, White, Ottenheimer & Baker

a) Legislative Developments

There have been no major legislative developments since our report in June 2006.

b) Judicial – Case Law

There have not been any major decisions of note since June 2006. However, the following may be of some interest in the area of bidding on a construction project and a claim for compensation beyond that set out in the contract.

Welcon (1976) Ltd. v. Town Council of South River (Town)

The Trial Division of the Supreme Court of Newfoundland and Labrador dealt with a contract dispute between a contractor and the consulting engineer and the municipality for which the work was being performed. The contractor sued for extra costs incurred during the installation of a water and sewer line, which it blamed on the consulting engineer for failure to disclose material facts regarding the soil. The court determined that the soil conditions encountered were well known to the construction industry, and that the risk of adverse soil conditions rests with the contractor. The court confirmed that in order to for a plaintiff to be successful in a claim for extra compensation there must be "extraordinary circumstances" not contemplated by the parties. In this case, because the risk of the soil conditions rested with the contractor and because the contractor should have been aware of the soil conditions, no extraordinary circumstances existed to justify extra compensation.

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