Behind the Eight Ball!

A Paul Mayer Story.

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At times rulings rendered by the courts take on a special flavour. Sometimes we know one of the parties or one of the lawyers pleading a case. The ruling we are discussing in this article is "flavourful" and interesting on a number of different levels. In fact, it is one of the first decisions rendered by my friend the Honourable Paul Mayer on September 17, 2010 on a leasing matter. Judge Mayer is a Superior Court Judge and a former columnist for eSpace Montreal. The case involves 9142-9134 Québec Inc. (Unison Bar & Billiard) (« Unison ») vs 9180-9293 Québec Inc. (Spheretech).

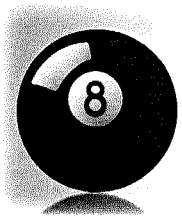
Having read countless articles written by Paul Mayer (he has to hold the Guinness record for number of articles published in eSpace!) I am very pleased to share with you a brief insight of his elegant penmenship.

In both form and content, Paul's style is faithful to his past as a columnist: his concern for detail, rigor and logic is combined with incisive insight. In this matter involving a landlord and a tenant operating a bar and pool room, Judge Mayor begins his judgement in the colourful way many will recognize: "As the manager of a newly purchased shopping centre, you know that your relationship with a tenant will be problematic when, the first time you meet him, he introduces himself by saying 'I'm the troublemaker here.'"

The tenant alleges that the landlord is in default of providing peaceful enjoyment of his premises due to several problems causing him substantial financial losses in his commercial operations. The establishment holds a "sport bar" and a restaurant with 44 pool tables, located in the Spheretech shopping centre at the intersection of Côte Vertu boulevard and the Trans-Canada highway in St. Laurent. The lease is for 20,000 square feet for a ten-year term, which expired March 31, 2010, and for which the tenant had the right to exercise two renewal options. According to the tenant, the operation does not generate profit and in fact show significant losses year after year.

After some negotiation, the tenant requested that the landlord either substantially diminish the rent, reduce the rental area or relocate its operations elsewhere in a smaller space. The landlord refused to modify the lease. The tenant's list of recriminations is very lengthy. Without going into all the details of each complaint, the tenant raised the purported following defaults on behalf of the landlord:

- The landlord leased space in Spheretech to La Cage aux Sports, a direct competitor of Unison, therefore breaching the good faith obligation of the landlord;
- The tenant holds the landlord responsible for the decrease in commercial activity of Cinema Guzzo given the fact that this tenant opened another cinema nearby; and
- The landlord's efforts to lease other space in the centre have been deficient.



Lease to a competitor and exclusivity clause

In commercial retail leasing, all landlords and developers have an obligation to judiciously assemble the proper tenant mix to ensure the appropriate synergy between the various retail operations so that all the retailers complement each other. While some retailers wish to operate in a circumscribed zone and specifically request an exclusivity, others invite competition, seeing an advantage in having competitors in proximity to their operations and therefore creating positive synergy. In the case of Unison, the tenant contests the fact that La Cage aux Sports, a direct competitor of Unison, be located in the shopping centre. However, one must note that there is no exclusivity clause in the Unison's lease. The

tenant, thererefore, argues that this is a violation of the landlord's obligation of good faith toward the tenant, Unison's operations being smaller than La Cage aux Sports and with whom the tenant cannot compete.

From the outset, Judge Mayer affirms the following:

> "There is no doubt that the introduction of a powerful competitor in a shopping centre can affect the profits of a tenant and can be seen as affecting the peaceful enjoyment of the premises.
>
> On the other hand, the freedom of commerce and the benefits of competition are values, which are recognized in our society.
>
> Without a specific exclusivity (or non-competition) clause in a lease, whereby a landlord agrees to grant a tenant the exclusive right to conduct a particular activity, the majority of the jurisprudence and doctrine has recognized the freedom of a landlord to lease his property to whomever he wishes. "

However, Judge Mayer also emphasized that the obligation of loyalty and good faith between the parties necessarily implies a reciprocal obligation between the parties. In fact, two decisions rendered by the Superior Court Posluns vs. Entreprises Normil Inc., J.E. 90-1131 C.S.), and 2981092 Canada Inc. vs. Société Immobilière Trans-Québec Inc. (1994 no AZ-5401894 C.S.) valued the concept that, even in the absence of an exclusivity clause in favour of a tenant, under particular circumstances, a tenant could claim violation of this obligation of good faith. Nevertheless, it is very important to note, as Judge Mayer quoted, that the Court of Appeal reversed the latter of these two decisions and to that effect Judge Mayer wrote the following:

> "Judge Rothman held that the use clause in the lease did not create an obligation on the part of the landlord to refrain from leasing space in the shopping centre to another tenant offering similar kinds of foods: "Unless there is some form of exclusivity granted to the tenant in the lease as a general rule, landlords are free to lease in the same building to another tenant offering similar products."

The Court of Appeal found no evidence of any violation of the landlord's duty of good faith in the decision to lease to the competing tenant. It held that if there existed a duty to maintain a balance of the kinds of business to be leased in the shopping centre, this had been specifically excluded in this lease given that there

« In conclusion, any tenant for whom the use of the premises is paramount to its commercial activities must insist on the inclusion of an exclusivity clause in its lease, if it can be obtained from the landlord, which in most cases is not an easy to obtain.

was no exclusivity clause. The Court found no abuse of right in the decision to lease to the competing franchise. It found no suggestion of malice or fraud and it held the sole motivation of the landlord was to select another restaurant operator for the food court that would attract as many customers as possible to the shopping centre."

In conclusion, any tenant for whom the use of the premises is paramount to its commercial activities must insist on the inclusion of an exclusivity clause in its lease, if it can be obtained from the landlord, which in most cases is not easy to obtain. In fact, it appears that the Court of Appeal has clearly established that in the absence of an exclusivity clause it is very difficult for a tenant to argue absence of good faith.

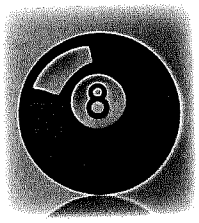
Cinema Guzzo in decline

The tenant complains to the landlord that Cinema Guzzo is in crisis in the shopping centre. He specifically blames the situation on the fact that Cinema Guzzo has opened another cinema in the Marché Central, cannibalizing its operations in the Spheretech. The landlord was forced to call on representatives of Cinema Guzzo to testify as to the decline of the cinema industry, among other things. The Court also notes that neither the Unison lease nor the Law contain a guarantee to the effect that Cinema Guzzo users will continue to come to the shopping centre. In addition, it is clear that the non-competing or radius clause was deleted from the Cinema Guzzo lease. As a result, the landlord could not prevent or stop Cinema Guzzo from opening in Marché Central. This constitutes a decision made by a third party that has nothing to do with the relationship between a landlord and a tenant. In fact, to conclude differently would have been incongruous.

The vacant space

Unison argues that the high vacancy of retail spaces in the shopping centre constitutes a default on the part of the landlord, as it causes prejudice to the tenant's peaceful enjoyment of the premises.

Any sophisticated tenant, especially where real estate project developments are involved, will insist on including a co-tenancy provision in their lease. These clauses frequently are limited in time and often linked to the opening of a shopping centre. It is very rare that a co-tenancy clause continues over time. For example, a tenant within a new shopping centre might request from the landlord that at least 75% of the leasable area be occupied or rented to other tenants, failing which the tenant may postpone the opening of its store or, even in some cases, cancel the lease. In fact, these clauses usually serve to protect the tenant during the construction of a new shopping centre, preventing the tenant from the possibility of being the only or one of the only tenants to be open and operating. Tenants who are successful in including such a co-tenancy clause for an undetermined period of time will certainly hold a very strong power of negotiation. In the case at hand, Judge Mayer points out the absence of such a co-tenancy clause.



However, Judge Mayer inquires as to whether or not this a violation of Article 1856 of the Civil Code which stipulates that a landlord cannot change the form or destination of the leased premises? In previous decisions rendered, the courts concluded in some cases that when retail spaces are left vacant in a shopping centre, this may result in a change of destination of the leased premises.

Judge Mayer emphasizes that in the decision rendered in Steerburger (Société d'investissements York- Hannover Ltée, C.S. no 500-05-000234-797, June 8 1979), the tenant rented four thousand square feet at the Metro level. The Landlord experiencing several problems with this Metro level decided to change the vocation and ceased leasing space, thereby hoping that all commercial activities of occupying tenants would eventually cease. In that case, the court concluded that it is implicit in a commercial lease that the landlord has an obligation to use his best effort to lease the commercial space in a shopping centre. As a consequence, the Court concluded that the landlord had failed in its obligation and thereby reduced the tenant's rental obligation up to and until 80% of the space on the Metro level had been leased.

In the Unison case, Judge Mayer concluded that the landlord had actively and diligently attempted to lease the vacant spaces in the Spheretech centre and therefore had not failed in his obligation. This leads us to conclude that, in this case, we are dealing with an obligation of means and not an obligation of result that prevails in the case of commercial leasing. On the other hand, the landlord must demonstrate that he has used his best efforts to lease to its full capacity his shopping centre.

Renewal option valid?

The last question Judge Mayer had to resolve in the case was whether or not the tenant's exercise of its renewal option was valid. The tenant had chosen to impose a condition to its exercise of the renewal option. In fact, the tenant inserted in his renewal

notice a statement to the effect that this renewal was exercised without prejudice and under reserve of all his rights with respect to the current litigation and the judgement to be rendered in this case, therefore looking for an eventual reduction of rent. It should be noted that the renewal option to be exercised stipulated a fixed predetermined rate of $13.25 per square foot.

Judge Mayer wrote the following:

> "The exercise of an option to renew the term of a lease by the tenant must be unequivocal and without condition. It is indivisible. It cannot be exercised on different terms. The conditional exercise of an option to renew, in a manner not provided for in a lease, will not be binding on a landlord. Its exercise requires complete compliance with terms and conditions stipulated in the lease. For example, Courts have not permitted an option to renew to be exercised with respect to only a portion of the leased premises."

Consequently, a renewal option cannot be validly exercised when the tenant makes it conditional to a reduction in rent, as was the case here. Judge Mayer's decision is in keeping with the jurisprudence to the effect that the courts have generally recognized that renewal option constitutes the law between the parties and that, when the mechanism has been clearly defined, any option to renew must be exercised strictly and in conformity with the mechanisms stipulated in the lease. In addition, the judge further clarifies that the renewal clause specifically stipulated that the option to renew could only be exercised provided that the tenant had paid all rent due and owing and upon tenant respecting all the terms and conditions of the lease. As stated by Judge Mayer this serves to protect a landlord from the exercise of an option to renew by a "troublemaker".

During the six days this trial lasted, the tenant learned at his own cost that his lease was terminated. Ironically enough, the tenant found himself "behind the eight ball". •