

**"ADVANCED SUB-LEASING: A CONSIDERATION OF
WHEN FLOW-THROUGH PROVISIONS IN SUBLEASES
ARE NOT QUITE APPROPRIATE"**

Prepared By: Natalie Vukovich
Law Society of Upper Canada
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DRAFTING FLOW-THROUGH PROVISIONS IN SUBLEASES

I. FLOW-THROUGH PROVISIONS

Often a sublease assumes that except for the rent, term and description of premises to be subleased, the tenant/sublandlord stands in the shoes of the headlandlord and the subtenant stands in the shoes of the tenant. This type of wording is often found in subleases: “the sublandlord will have the rights/obligations of the head landlord under the head lease and the subtenant will have the rights/obligations of the head tenant under the head lease, as if the subtenant were the tenant and the sublandlord were the head landlord under the lease”. In this paper I refer to this wording as the “Mirror Image Wording”. Frequently, the Mirror Image Wording is either inadequate or dangerous. At the very least, it reveals too casual an analysis.

A subtenancy is not always a mirror or a subset of a head tenancy. For example, a property may be the subject of a land lease, under which there is a building lease. Under the building lease there are office, retail or industrial space leases, and under some of these space leases there are garden variety subleases. It may come as a surprise to you that in this scenario, the building lease is a sublease. Likewise, the space leases are sub-sub-leases. The garden variety subleases are actually sub-sub-sub-leases! It would not be considered even slightly unusual that the ground/land lease would import flexibility in favour of the lessee whereas the building lease would be somewhat more restrictive. The individual space leases would be even more restrictive, likely written on some type of standard landlord form of lease. No one would

expect the Mirror Image Wording to work when documenting these very different “sub-relationships”. To the contrary, one would understand that each transaction might entail its own full-blown lease. Only the sub-sub-sublease would be considered as a "no-brainer" transaction - in all likelihood, the documentation related thereto would incorporate some sort of Mirror Image Wording.

There are many examples of underlease transactions where the terms of the underlease are substantially different than those found in the headlease.

More commonly, we think of subleases as those that arise in the context of office or industrial space, where the subtenant is to occupy part of the space leased or alternatively subsidize some of the rent obligation sought to be mitigated by the tenant who no longer desires the space. Likewise, in a retail setting, franchised outlets are frequently operated by subtenants. In each of these cases, the subtenant apparently “stands in the shoes of” the head tenant/franchisor and it may very well be that the analysis given to drafting the sublease should be abbreviated.

In this paper I am concerned with scrutinizing the aspects of the relationship between the superior landlord(s) and superior tenant(s) to the extent that they flow through to the sublandlord and/or subtenant. Some aspects of a superior lease relationship may flow through automatically, some may not, some should flow through and some should not. I intend to explore many aspects of flow-through provisions in subleases, but with a word of caution that there is no

singular approach to these issues that is the correct approach and that there may be many more issues to explore in any given underlease transaction beyond those that are addressed herein. Each issue requires thought as to its application to the circumstances of the particular subtenancy. I intend to review the issues in a “checklist” manner so as to suggest some of the considerations but not leave the reader with the impression that I have exhausted the topic.

First, a couple of preliminary matters – documentation, and certain overriding principles to be aware of before tackling flow-through issues.

II. PRELIMINARY CONSIDERATIONS

1. Documentation

What type of documentation is to be used? There are a few different approaches. Two of the most common are:

- (a) The sublandlord and subtenant may have their own direct deal, i.e. a 2 party sublease (or it may even be termed a “lease” as mentioned above where the superior lease is actually a ground lease or a building lease). A separate document evidencing the head landlord’s consent may or may not be required under the terms of the head lease. (The subtenant should inquire into this and not make any assumptions.) The subtenant may require a separate document containing a covenant from the head landlord to allow for any

variations from the terms of the head lease insofar as they pertain to the subleased premises (e.g. use, trade name, building/unit/directory signage). Is the head landlord entitled, under the terms of the head lease, to require that the subtenant covenant with the head landlord to perform the obligations of the tenant under the lease insofar as they relate to the subleased premises (e.g. the covenant to repair the premises in case of a fire)? The consent and the covenant(s) may be documented separately. The subtenant may seek a non-disturbance agreement from the head landlord so that if the sublandlord fails to perform its head lease obligations, the subtenancy remains secure (or the subtenant may prefer to rest on its common law rights, as discussed below).

- (b) Alternatively, there may be a three-party document evidencing the relationship of the three parties (Head Landlord, Sublandlord/Tenant and Subtenant) to each other. If so, the flow-through aspects (set out below) should be critically examined to determine whether they are sufficiently addressed in the agreement. In my experience, three-party sublease documents are generally quite succinct and sometimes fail to cover enough bases relative to many of the flow-through issues addressed in this paper¹. However, where there are few discrepancies between the underlease terms and those of the superior lease under which it arises, i.e. where it is intended that everything “flows through”, a 3-party agreement may provide a suitable platform (although the Mirror Image Wording may not suffice to achieve the desired degree of flow-through).

2. Common Law and Statutory Provisions

It is important to keep in mind certain pervading principles that apply to subleases as a result of statute and/or the common law.

The most basic common law principle is that a head tenant cannot convey to its subtenant an interest which is greater than its own interest. Not only can the head tenant not convey a lengthier term to the subtenant than that which it itself enjoys, the head tenant must convey *less* than it enjoys or else the sublease will be legally regarded as an assignment². Likewise, any other restrictions set out in the head lease (such as the use restrictions, or the limitations on assignment and subletting) must be respected in the sublease.

A somewhat more obscure/ancient common law principle is that privity of estate is destroyed upon surrender of the tenant's interest, and, as a result, following the surrender of the head lease, a subtenant is released from all its obligations under the sublease but is in a lawful position to enjoy the property for the balance of the term of the sublease without payment of rent or

¹ Haber, H. (Q.C.) *"Assignment, Subletting and Change of Control in a Commercial Lease: A Practical Guide"*, *Canada Law Book, 2002*". In particular, the chapter entitled: "Commentary on a Landlord's Form of Sublease", at p. 121.

² *Goldman v. 682980 Ontario Ltd.*, [2001] O.J. No. 3005 (Sup. Ct.); (2002), 3 R.P.R. (4th) 198 (C.A.)

observance of any covenants³. This only applies because there is no privity of estate as between the head landlord and the subtenant, but if there is privity of contract in the form of a written agreement between the subtenant and the head landlord, the subtenant will continue to remain liable⁴. This common law rule even applies where the head landlord is unaware of the existence of the subtenancy⁵, but *it is overridden in Ontario* by Section 17 of the CTA (see comments below).

Another common law principle to bear in mind is that covenants in the superior lease that touch and concern the land (e.g. the covenant to repair, not to use the leased premises other than in a certain prescribed manner) encumber the title and as such, they run with the land, binding the under-lessees even without documentation to that effect⁶. A release from the superior lessor of the particular covenant would be necessary if it were intended that this consequence was to be avoided.

³ Ontario Law Reform Commission, *Report on Landlord and Tenant Law* (1976), at 37.

⁴ C. Bentley, *Williams & Rhodes, Canadian Law of Landlord and Tenant*, Volume 1, 6th ed. (Toronto: Carswell, 1988) at 12-24 & 12-25; L. Blundell, *Woodfall's Law of Landlord and Tenant*, Volume 1, 27th ed. (London: Sweet and Maxwell, 1968) at 17/18; A.H. Oosterhoff and W.B. Rayner, *Anger and Honsberger Law of Real Property*, (Toronto: Canada Law Book, 1985) v. 1 at page 291; Ontario Law Reform Commission, *Report on Landlord and Tenant Law* (1976), at 37; *Royal Bank of Canada v. Loeb Inc.*, [1995] O.J. No. 1702 (Ontario Court (Gen. Div.), June 8, 1995, Feldman J.); *Webb v. Russell* (1789) 3 Term. Rep. 393.

⁵ A.H. Oosterhoff and W.B. Rayner, *Anger and Honsberger Law of Real Property*, (Toronto: Canada Law Book, 1985) v. 1 at page 291; *Parker v. Jones*, [1910] 2 K.B. 32.

⁶ Posen, S.J., *Haber, H.M., Shopping Centre Leases*, Vol. 1, Canada Law Book Limited, 1976, at p. 371.

There are more common law issues to consider but they are beyond the scope of this paper⁷. There are also three very important statutory provisions to bear in mind when drafting subleases:

a. **Section 21 of the Commercial Tenancies Act (“CTA”)**

If the head lease is terminated by the head landlord enforcing a right of re-entry or forfeiture under the head lease, the sublease is also considered terminated⁸. However, Section 21 of the CTA permits a subtenant to apply to the court for relief from forfeiture, permitting it to retain its leased premises as a direct tenant of the head landlord. The Court has discretion to impose lease terms as to *inter alia*, payment of rents, expenses, compensation and giving of security, but the term cannot exceed the term granted to the subtenant under the sublease and any options to renew⁹. Note that Section 21 only applies in cases of termination arising from a head landlord exercising a right of re-entry or forfeiture. Where a contractual option to terminate the head lease is exercised by the head landlord, no right to apply for relief is available to the subtenant¹⁰.

⁷ Recognizing that it is bad form to quote one’s self, I nevertheless refer you to a chapter in Harvey Haber’s latest book, “Assignment, Subletting and Change of Control in a Commercial Lease” (*Supra*, #1), in particular a chapter I authored: “Subletting – Tricks and Traps”. There, you will find more analysis of these issues as well as some analysis of a few other common law issues to take into account when dealing with subleases. Further, in relation to the three provisions dealt with next, I have commented in that chapter on the perspective of a head landlord (who would ideally have any subtenant waive all statutory or other rights to elect to become the direct tenant of the head landlord).

⁸ Re Roanne Holdings Ltd. v. Victoria Wood Development Corp. Ltd. (1975), 58 D.L.R. (3d) 17 (Ont. C.A.); Toronto Harbour Commissioners v. T.H.C. Parking Inc. (1999), 175 D.L.R. (4th) 536 (Ont. S.C.J.).

⁹ S.21 Commercial Tenancies Act.

¹⁰ Maverick Professional Services Inc. v. 592423 Ontario Inc., [2001] O.J. No. 1877 (C.A.)

b. Section 17 of the Commercial Tenancies Act

This section provides that where a tenant surrenders the head lease, the head landlord becomes an assignee of the interest of the tenant (sublandlord) in any (valid) underlease granted by the tenant. In other words, a subtenant's rights are not disturbed where the head lease is surrendered. The head landlord becomes the direct landlord of the subtenant under the terms of the sublease. This only applies with respect to a surrender of a lease and not to a termination of the lease by the landlord¹¹.

c. Section 39(2) of the Commercial Tenancies Act

This section affords to a subtenant, occupying the premises with the approval or consent in writing of the landlord, the ability to protect its leasehold interest in the event of the bankruptcy or winding up of the head tenant, by electing within three months of the filing of the bankruptcy or the issuance of the winding up order to take over the head lease on the same terms and conditions except as to rent. If the subtenant makes this election, it will be required to pay to the landlord a rent which is the greater of the amount payable under the sublease and the amount payable under the head lease¹². The subtenant need not pay any arrears accumulated by the head tenant in order to make the election under Section 39(2)¹³. Under this section, a subtenant can

¹¹ *Shapiro v. Handleman*, [1974] O.R. 223 (C.A.); A.H. Oosterhoff and W.B. Rayner, *Anger and Honsberger Law of Real Property*, (Toronto: Canada Law Book, 1985) v. 1 at page 291.

¹² *Hammersmith Manor Enterprises Inc. v. Frazzor Corp.* (1991), 4 O.R. (3d) 46, 19 R.P.R. (2d) 87 (Gen. Div.)

¹³ *Westhill One Ltd. v. Taylor* (1989), 70 O.R.. (2d) 93 (H.C.)

actually defeat the rights of the bankruptcy trustee to elect to affirm, assign or disclaim the lease within 3 months after the bankruptcy¹⁴.

A head landlord need not have consented *in writing* to the sublease in order for Section 39(2) to be available to the subtenant¹⁵. The courts have said that the "approved or consented to in writing" feature of Section 39(2) protects landlords from only phantom subtenants - but it is not clear whether subtenants, in occupation by virtue of the head lease containing no prohibition against subleasing, can make the election under Section 39(2). It is also not clear whether a subtenant of a part only of leased premises could make an election under Section 39(2) in respect of its subleased premises only, "trumping" the bankruptcy trustee with respect to the subleased premises only (or even in cases where the bankruptcy trustee disclaims the lease under Section 38(2)). Contrasting the judicial discretion entailed in a Section 21 relief from forfeiture application against the lack of discretion under Section 39(2), I predict that a subtenant's rights under Section 39(2) pertain only to the subleased premises.

III. WHAT TO FLOW-THROUGH, WHAT TO DISTINGUISH

Set out below are many (but certainly not all) of the flow-through issues to consider when drafting subleases. Ask yourself whether provisions from the superior (or head) lease ought to

¹⁴ *In the Matter of the Bankruptcy of 572141 Ontario Inc.*, Court File No. 31-OR-206330-T, unreported.

¹⁵ *Majdpour v. M&B Acquisition Corp.*, [2001] O.J. No. 1113 (Sup. Ct.); [2001] O.J. No. 4932 (C.A.) (QL)

flow through to the subtenant. Also consider whether the sublease and/or related documentation requires additional attention in order to achieve the parties' intentions.

1. Rent

- what amount is payable?
- is it correct to state that the subtenant will perform all of the obligations of the tenant under the head lease or should there be a carve out in relation to rent?
- to whom does the subtenant make payment? Can/should the head landlord be able to direct the subtenant to pay directly to the head landlord, can/should the subtenant be entitled to insist that it pay directly to the head landlord?
- for additional rent year-end reconciliations under a net lease, does the head landlord owe an obligation to the subtenant to deliver the adjusting statements to it or does it deal only with the head tenant? If the latter, does the head tenant owe an obligation to the subtenant to deliver the adjusting statements to the subtenant? If the subleased premises are part only of the leased premises, who performs the adjustment as it relates to the subleased portion?
- if Percentage Rent is payable, calculated as a function of gross sales from the subject premises, who must certify the sales reports? If the head lease requires the Tenant's auditor to certify the reports, will the subtenant's auditor's certification suffice to meet the obligation? At whose premises may the head landlord's auditor attend for

purposes of conducting an audit? Can the head landlord require the sublandlord to perform an audit, as if it were the head landlord auditing the sales reports of the head tenant, against the subtenant (i.e. for the benefit of the head landlord)? In case the audit reveals no significant discrepancy, must the head tenant bear the cost of the audit?

- if the tenant/sublandlord has an audit right under its head lease in relation to the CAM Charges and/or realty taxes passed through by the head landlord under the net head lease, does the subtenant enjoy the benefit of that right too? Must/can it require the sublandlord to undertake the audit? Who bears the cost of the audit if the subtenant conducts the audit “standing in the shoes of the tenant” and finds the margin of error that, pursuant to the head lease, would have required the head landlord to pay had the tenant conducted the audit?

2. Term and Tenure Generally

- the sublease term must be shorter than the head lease term in order to qualify as a sublease (often this is achieved by reserving a one-day period at the end). A subtenant may seek additional term from the head landlord; the industry phrase for this is called a “wraparound term”. For the wraparound term, the subtenant negotiates with the head landlord and does its own direct deal. The subtenant may wish to obtain an acknowledgment from the head landlord that it will not require the subtenant to vacate the premises for the one day that it is not officially entitled to occupy the subleased premises as subtenant. In that acknowledgment, the status of

the subtenant during that period should be clarified: it might occupy as a licensee or as an agent of the head tenant. The head tenant must be a party to this term. The head landlord must protect itself in the wraparound deal in case the sublease and/or head lease is terminated, i.e. it must reserve the option to terminate the wraparound. Likewise, the subtenant will require the ability to avoid the wraparound commitment if the sublease is terminated as a result of factors other than the default of the subtenant.

- if the head lease contains a renewal option and the subtenant negotiates a wraparound term, the subtenant and head landlord must obtain the head tenant/sublandlord's agreement to either not exercise its option to renew or acknowledge that it is deleted and no longer available to the head tenant. Alternatively, if the subtenant does not negotiate a wraparound term yet it wishes to enjoy longer tenure than merely the initial sublease term, it must obtain the sublandlord's agreement to exercise the option to renew if so required by the subtenant, and if so, the timeline for exercising the option must be accommodated so that the subtenant can obtain confirmation of the renewal before it is too late. In these circumstances there should also be an agreement as to whether the subtenant may stand in the shoes of the sublandlord, in some capacity, to negotiate the renewal rental rate (if the option is at a rent to be negotiated).
- if the head lease is terminated, surrendered or disclaimed, the subtenant may need protection of tenure. How can it achieve this? Through reliance on the provisions of the Commercial Tenancies Act provisions (see paragraph II(2) above) and/or a non-disturbance agreement with the head lessor. I have also seen subtenants succeed with

a separate agreement with the head landlord containing a right of first refusal to lease (directly from the head landlord) the subleased premises in the circumstances outlined.

3. Maintenance, Repair and Restoration

- what are the end-of-term restoration responsibilities? Are they the same as between subtenant and head tenant? What if the head tenant has restoration responsibilities and the subtenant does not? For instance, if the subtenant installs an internal stairway between two floors of its office space (and/or specialty HVAC or drywall ceilings), then does the head tenant have to remove and restore on expiry even though these treatments were installed by the subtenant with the approval of the head landlord? Is the situation any different if the subtenant and the head landlord are one and the same party and the subtenant (*quasublandlord*) agrees with a sub-subtenant that its restoration responsibilities are not as onerous as those owed by the head tenant to the head landlord under the head lease?
- what can the subtenant remove from the subleased premises during the term? Does it require/deserve greater flexibility than what is contemplated by the head lease?
- who is responsible for repairing etc. the Common Areas? The HVAC? The Mirror Image Wording suggests that the sublandlord is responsible for the obligations of the head landlord but how does the sublandlord perform them if it is not granted the authority to perform them under the head lease? Does the subtenant have to enforce

these obligations through the sublandlord or can it deal directly with the head landlord? If the sidewalk in front of the store is disintegrating or the elevators leading to the tenant's office suite are malfunctioning, how can the subtenant obtain redress? Is the sublandlord responsible for any of the duties if the head landlord does not perform them?

4. Use and Exclusive Use Restrictions

- is the subtenant's use the same as the head tenant's? If not, has the head landlord allowed the subtenant's use through permissive language in the head lease or is it necessary to amend the head lease to permit the change in use? Is the permitted change in use personal to the subtenant or does the head tenant enjoy that right as well if it re-takes possession of the subleased premises?
- if there is to be no privity of contract between the head landlord and the subtenant and the subtenant departs from the permitted use, how will the head landlord enforce its rights? It may not wish to terminate the head lease owing to market conditions, yet any other alternative will require legal action that could be costly.
- how will the sublandlord enforce a use restriction against the subtenant, are there adequate enforcement provisions?
- if the head tenant/sublandlord is entitled to the protection of an exclusive use restriction under the head lease, does the protection extend to the subtenant as well,

and if so who gets to enforce the right as against the head landlord? Is it necessary for the subtenant to join the head tenant in any proceedings or may it be independent?

5. Co-Tenancy/Depletion

- if the head lease contains a provision whereby the tenant is entitled to pay a reduced rent or terminate the lease if certain vacancy levels (in relation to the rest of the multi-tenanted property in which the leased premises are located) are achieved, then is the subtenant entitled to the benefit of those rights? If the head lease states that the benefit of the co-tenancy provision is only available so long as the named tenant is in occupation of the whole of the premises, the sublease may negate the provision unless the head landlord acknowledges otherwise (in writing). It is not automatic that a rent reduction available under a head lease flows through to the benefit of the subtenant. If the parties agree that it should, they will have to draft wording to achieve that arrangement.
- it may be that the sublease rent is less than that which is payable by the head tenant under the head lease, in which case it is also necessary to consider the rate of reduction, if any, that applies to the sublease rent if the stated circumstances arise.
- it is possible that the subtenant and head tenant will have their own agreement as to a co-tenancy/depletion feature in the sublease, i.e. one that is distinct and different than that which is expressed, if any, in the head lease. This may not be problematic so long as the sublandlord/head tenant recognizes what it is agreeing to. The head

landlord is advised to exercise caution when consenting to the sublease. It should state that its consent is a mere consent to the existence of the sublease but not to any of the terms of the sublease, so that it will not itself become bound to terms that are not contained in the head lease.

6. Sign Rights/Building Naming Rights/Parking Rights

- the head lease may provide that the tenant is entitled to affix exterior signs on the building of which the leased premises form a part. The tenant may be responsible for all repairs to the signs. The subtenant will not enjoy those rights merely by taking a sublease interest in all or a portion of the leased premises. If the sublease contains Mirror Image Wording, the subtenant may inadvertently take on the obligation to maintain and repair a sign bearing the head tenant's name. If the head tenant wishes to pass those rights on to the subtenant, the terms of the head lease will govern as to whether the tenant will be in a position to do so and an express provision to that effect will be required. If the head lease states that the sign rights are only available so long as the named tenant occupies a certain total area of the leasable premises in the building, the sublease may deprive the head tenant of the sign rights (unless the head landlord acknowledges otherwise, in writing).
- the tenant may be entitled (under the head lease) to have its name displayed on all directory boards serving the multi-tenanted property, but this will not entitle the subtenant to enjoy this privilege unless the head landlord agrees, in writing, to allow the subtenant to be so recognized.

- the same considerations apply with respect to building naming rights and parking rights. The intention of Mirror Image Wording may very well be that they are to flow through to the subtenant, but absent express consent from the head landlord, they will not. Likewise, if a number of parking spaces in the common areas is set aside for exclusive use by the tenant's customers, and the tenant is entitled to police/enforce the exclusive use by towing or ticketing any offending vehicles, then the mere grant of a sublease interest will not suffice to grant the subtenant those enforcement rights. A written acknowledgment from the head landlord is required to give the subtenant the necessary standing to carry out the enforcement measures.

7. Rights of First Refusal, Right of First Offer

- if the head lease gives the tenant a right to match a third party offer to lease adjacent space or to make the first offer on space that becomes available for lease, the subtenant will not be entitled to exercise that right unless both the head landlord and the tenant have agreed that it flows through to the subtenant. If the head landlord will agree to extend that right to the subtenant, is the subtenant's right dependent on the head tenant exercising the right and leasing the space from the head landlord in order to sublease it to the subtenant or will the subtenant have the right to lease the space directly from the head landlord? If the former, the subtenant may require the ability to force the tenant to exercise the right, and the timelines for each party's exercise will have to be properly established so that if one party is to wait on the other's notice, the appropriate domino chain of notices is accommodated. If the latter, the head tenant

- must either subordinate its right to that of the subtenant or it may relinquish it altogether. The subtenant will have to be “in the loop” if a third party offer comes in to the head landlord or if space becomes available for lease. This will entail extracting a covenant from the head landlord to notify the subtenant of any available space and/or third party offer being presented to the head tenant for consideration. If the head landlord is unwilling, the subtenant will have to rely on its sublandlord.
- if the head lease gives the tenant a right of first refusal to purchase the property, this right does not automatically flow through to the subtenant but Mirror Image Wording would be problematic as it would suggest that it does. Clearly, it will be problematic if the subtenant and the head tenant both have the same right of purchase.

8. Transfer Provisions

- the head lease may allow the landlord to arbitrarily withhold its consent to an assignment of the lease or a subletting or other parting with possession of all or any portion of the leased premises (a “transfer”). The sublease must respect the head landlord’s position in that whatever rights are to be granted to the subtenant, they must not undermine the head landlord’s rights. That is not to say that the sublandlord must reserve to itself the right to arbitrarily withhold its consent to a transfer by its subtenant, just that the sublease must qualify whatever rights are granted to the subtenant as being subject to compliance with the terms of the head lease, i.e. subject to obtaining the consent of the head landlord.

- the head lease may grant the head landlord the right to terminate the lease in lieu of consenting. The Mirror Image Wording may or may not achieve the same right, as between the sublandlord and the subtenant. If the sublandlord and subtenant agree that the sublandlord will have the right to terminate in lieu of consenting, the sublease provisions should be explicit in this regard. If there is no right of termination in favour of the sublandlord, the subtenant must nevertheless recognize that its transfer rights are affected by the right of the head landlord to terminate under the head lease. The right of the head landlord to terminate under the head lease may be expressed as a right to elect to accept a surrender of the head lease, in which case the head landlord must consider the impact on such a decision of Section 17 of the *Commercial Tenancies Act*.
- if the head lease allows the landlord to unreasonably and arbitrarily withhold its consent to a transfer for the first two (2) years of the head lease term and the sublease documentation imports Mirror Image Wording, then if the sublease commences midway through or even after the first two (2) years of the head lease term, does the sublandlord no longer have the right of unreasonable/arbitrary withholding of consent to a transfer by the sublease? The parties should be clear about this issue and address it explicitly.
- if the head lease allows the landlord to increase the rent, or scoop the excess rent payable on a transfer as a result of improved market conditions, how is it intended that these provisions will apply in the context of a transfer at or below the level of the subtenant? If the sublease rent is lower than the head lease rent but the sub-sublease rent is higher than the sublease rent yet lower than the head lease rent, is there an

excess to pay over to the head landlord or should it belong to the head tenant? Where does the documentation deal with this?

- if there are legal costs and/or administrative fees to be reimbursed or paid to the head landlord as a condition of its consent to a transfer by the tenant, does the Mirror Image Wording suffice to ensure that the subtenant likewise pays such costs and/or fees to the sublandlord upon a sublease transfer? Is it clear as to who pays the head landlord's legal costs and/or administrative fees, as between the sublandlord and the subtenant, in the event of a transfer by the subtenant?

9. Damage & Destruction

- if the head lease contemplates that the rent will abate in certain circumstances of casualty, it does not automatically follow that the sublease rent will abate. On the flip side, just because the head lease does not call for any rent abatement in case of a fire, that does not mean that the sublease cannot provide for rent abatement if the sublandlord is prepared to absorb that risk/cost. A subtenant is well advised to spell out the rent abatement rights.
- if the head lease contemplates that either the landlord or the tenant will have a right of termination in certain instances of damage and destruction, the subtenant will be at the mercy of the landlord's termination right¹⁶ but it will not have the benefit of the

¹⁶ Maverick Professional Services Inc. v. 592423 Ontario Inc., [2001] O.J. No. 1877 (C.A.)

tenant's right of termination unless specifically so provided. A subtenant must spell out its right of termination, taking into account any superior rights to terminate set out in the head lease (and it must pay attention to the timelines established in those provisions). A subtenant may obtain a right of termination even where the head lease does not provide one, if the sublandlord is willing. The head landlord need not participate in this agreement to validate it; the term governs only the relationship between the sublandlord and its subtenant.

10. Insurance

- the covenant to name the landlord and its mortgagee as additional or named insureds on the tenant's policies does not automatically expand to include the sublandlord as an insured where the subtenant signs on using the Mirror Image Wording. The sublandlord may not be concerned with this if it is satisfied that the subtenant will place the necessary insurance in favour of all of those parties and the sublandlord will continue to place its own coverage. However, this is probably unnecessarily duplicative and costly; it would be preferable for the sublease documentation to clearly address whether the subtenant will be placing the insurance that is required to be maintained by the sublandlord (as head tenant) in addition to the sublandlord's insurance or in lieu thereof. The head landlord may or may not require double coverage.
- all of the other provisions of the head lease as to the various features to be found in the tenant's insurance policies must be scrutinized as to the means by which these

requirements will be achieved. If there are to be waivers of subrogation in the subtenant's policies, must they be in favour of the head landlord only or the sublandlord as well? If the tenant is entitled to self-insure for certain risks, does that privilege extend through to the subtenant? If the head lease calls for the tenant to place whatever coverage it normally places under its blanket policies of insurance, does the subtenant enjoy a similar right or is it more constrained relative to what insurance it must place and if so, by what terms? Does the head landlord's approval rights over the tenant's policies of insurance extend to the subtenant's policies too or is it only the sublandlord who will have those rights of approval? Is the situation any different where the subtenant subleases only a portion of the leased premises?

11. Default

- this is the feature that most commonly is subjected to the Mirror Image Wording treatment. It is confusing, to say the least, as to whether the cure periods are thereby intended to run concurrently, i.e. should the head tenant wait for the subtenant to cure and if it does, then what happens if the subtenant does not cure the default? Will the head tenant have run out of time to cure the default in order to stave off the head landlord's remedial action? It may be appropriate to provide shorter cure periods in the sublease than are provided in the head lease, to allow the head tenant sufficient time to recover from its subtenant's default.
- if the subtenant pays the sublease rent to the head tenant who fails to remit the head lease rent to the head landlord, will the subtenant receive notice of the head tenant's

default? How can the subtenant enforce the head tenant's obligations? It is helpful to a subtenant to know that, in relation to distraining, Section 32 of the *Commercial Tenancies Act* states that the head landlord may not distrain against the goods of a subtenant where the subtenant, inter alia, pays the sublease rent to the head landlord or so much thereof as is sufficient to extinguish the head landlord's claim opposite the head tenant. However, in cases of all other remedies, the subtenant may not have recourse if the head lease is not kept in good standing, even though the subtenant complies with the sublease terms. The right to apply for relief under Section 21 of the *Commercial Tenancies Act* may be a hollow right if the subleased premises comprise only a part of the leased premises¹⁷. The subtenant may seek to write some protections into the sublease documentation, including the head landlord as a party therein, so that it can manage its own destiny. These protections might include a non-disturbance agreement from the head landlord, a right to receive notices of all defaults given by the head landlord to the head tenant and the right to cure the head tenant's defaults within the same period afforded to the head tenant at the expense of the head tenant.

- a provision in a head lease for accelerated rent on default will not necessarily flow through to the benefit of a sublandlord in case of a default by the subtenant, although possibly the Mirror Image Wording will be adequate for this purpose. Where the subtenant covenants with the head landlord to perform and observe the covenants, conditions and agreements of the head tenant under the head lease, and the parties

¹⁷ Golden Griddle Corporation v. City of Toronto (1997), 33 O.R. (3d) 545 (C.A.), leave for appeal dismissed [1997] S.C.C.A. No. 379

agree that the head landlord may direct the subtenant to remit the sublease rent directly to the head landlord, this may suffice to allow the head landlord to accelerate the sublease rent if it is not paid when due while the sublease documentation may also allow the sublandlord to accelerate the sublease rent if it is not paid when due. Leaving aside the question of whether accelerated rent provisions are even enforceable due to their *in terrorem* qualities, this type of mix-up (double rent acceleration on default) should be avoided through the use of clear documentation.

12. Enforcing the Head Landlord's Obligations

- if the head landlord fails to perform its covenants and obligations, the subtenant may have no remedy. For instance, the head landlord may have covenanted that it would not erect any buildings in a particular area in front of the tenant's premises. Or the head landlord may fail to live up to its covenant to keep the building open on a 24/7 basis. Even if the head lease grants certain rights and remedies to the tenant to invoke in instances of the default by the head landlord, these may not be available to the subtenant.
- the subtenant may seek after-hours usage of utilities – may it contact the head landlord directly and does it have standing to request such services or must it funnel its request to the head landlord through its sublandlord?
- if the head landlord covenanted not to make any site plan changes without the tenant's approval, this covenant may not extend to the benefit of the subtenant. The

subtenant may have to seek recourse against only the sublandlord for failing to obtain the subtenant's approval of site plan changes, if the tenant approved of site plan changes without consulting the subtenant. The basis for the claim against the sublandlord may be flimsy if the sublease did not require the sublandlord to consult the subtenant. The subtenant would have to allege some sort of good faith or fiduciary duty argument and the redress available from the sublandlord may be inadequate.¹⁸

- a subtenant is well advised to seek a covenant from the head landlord to perform all of the obligations of the head landlord under the head lease in favour of the subtenant. The head landlord should be concerned about making this promise, particularly if the subtenant subleases only a portion of the leased premises, as it may be too broad a promise. Furthermore, it opens up the field of potential claims in relation to issues that may be regarded by the head tenant as unimportant or inconsequential breaches. This covenant extends a contractual relationship to the subtenant in the presence of an overlapping commitment to the head tenant. The subtenant and head tenant may not always see eye to eye, and the head landlord may get caught in the crossfire.

¹⁸ Although it must be noted that in the recent decision of *Country Style Food Services Inc. v. 1304271 Ontario Ltd.*, (2003), 7 R.P.R. (4th) 184 (Ont. S.C.J.), these arguments met with resounding success.

13. Estoppel Certificates/Registration of Lease/Subordination and Non-Disturbance

- the head lease covenant to deliver an estoppel certificate may not permit the head landlord to extract such a certificate from the subtenant. The sublandlord's estoppel certificate may have to be qualified to the extent that it depends on the subtenant for information and/or performance of obligations. The estoppel certificate may not satisfy a purchaser or lender. The Mirror Image Wording might suffice to allow the sublandlord to obtain an estoppel certificate from the subtenant but the head lease may not allow the head landlord to insist that the sublandlord invoke its rights and present an estoppel certificate signed by a subtenant.
- the head lease provision entitling the head tenant to register notice of its lease on title to the lands does not typically entitle a subtenant to register notice of its sublease. If the subtenant wishes to register notice, it will require the head landlord's written permission.
- the head lease provisions requiring subordination of the head lease in favour of a mortgagee will not typically oblige the subtenant to subordinate its sublease, nor will the provisions entitling the head tenant to obtain a non-disturbance agreement from a mortgagee serve to allow the subtenant to obtain such an agreement from a mortgagee. If a head tenant registers its notice of lease on title and a subtenant is able to register notice of its sublease on title, then subsequently the landlord wishes to finance the property and invokes the subordination provision to ensure that the lease will rank behind the mortgage, the subtenant may make life difficult for the landlord as it may not have any obligation in favour of the head landlord to subordinate and

the mere subordination of the head lease will not necessarily satisfy the potential mortgagee that the sublease is out of the way in terms of priority.

Conclusion

Subleases are or should be as involved and complicated as leases are. It's unfortunate that Mirror Image Wording is so often used in subleases: this reveals a short-changing of the analysis required to get it right.

I urge you to take the time to think through what aspects of a superior lease should properly flow through to an under tenant. After taking that time, go the next step and think through whether the wording you're using gets the job done. More often than not, you'll have to contend with the inadequacy of Mirror Image Wording.

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