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**A FEW OPERATING ISSUES:
RELOCATION AND GO DARK RIGHTS**

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This paper considers two operating issues: relocation rights and issues concerning tenant's Right to go dark.

A. RELOCATION CLAUSES

1. Generally

A relocation clause allows a landlord to move a tenant from its original location to other premises in the same building or shopping centre or complex. In both the retail and office context, relocation clauses are of great importance to a landlord as they permit the landlord to remerchandise and/or expand its property - all with minimal interference from uncooperative tenants. Moreover, relocation clauses also allow a landlord to take advantage of business opportunities insofar as the landlord may need to relocate a tenant in order to accommodate the expansion of a key tenant or to make room for a new tenant. At law a landlord is not permitted to relocate a tenant unless a right of relocation has been incorporated into the lease.

From a tenant's point of view, there are few clauses in a lease that are as objectionable as the landlord's right of relocation. Not only may the landlord's exercise of a relocation right cause the tenant to lose a highly desirable location in the shopping centre, the relocation itself may cause significant disruptions to the tenant's business. Tenants also fear that a certain amount of goodwill may be lost as a result of the move. This being the case, tenants should be careful to negotiate narrow perimeters in which relocation rights operate.

2. Enforceability of Relocation Clauses

Some commentators have suggested that since a relocation clause permits a landlord to alter the location of the premises, the clause is unenforceable as it means that the premises may not be identified with sufficient certainty¹. Fortunately for landlords, the force of this argument has been undermined by two Canadian judicial decisions. In *C.T.R.E.F. Investment Ltd. v. H.G.O. Real Estate Ltd.*,² the Court *inter alia* dismissed the tenant's argument that the landlord's right to relocate was void. The relocation clause at bar permitted the landlord to relocate the tenant if, in the landlord's reasonable opinion, the relocation would be for the betterment of the plaza. The Court noted that there is a "community of interest" among tenants of a shopping centre which creates a direct interest in each tenant to ensure that the leases of other tenants are also enforced. This principle, in turn, permitted the landlord to relocate the tenant because the landlord was proceeding in good faith and was adhering to the spirit of the relocation clause. Moreover, the changes proposed by the landlord were for the overall benefit of the shopping centre and the tenant was not being singled out. In *Sr. John's Development Corp. v. Eyeland Enterprises Inc.*,³ the lease provided that the landlord could

¹At law, a valid lease requires *inter alia* that the premises be defined with sufficient certainty.

²[1993] O.J. No. 1194 (Ontario Court of Justice (General Division), May 31, 1993, O'Driscoll J.)

³[1998] N.J. No. 295, (Newfoundland Supreme Court, October 16, 1998, Riche J.).

relocate the tenant provided the new location was comparable in size. The tenant occupied premises which had interior and exterior mall exposure. The new premises were to be located at the rear of the mall. Despite the fact that the new location was far inferior to the tenant's existing premises, the Court upheld the landlord's right to relocate and noted that "the tenant by executing the lease and including this relocation clause put itself in the position whereby it was at the mercy of the landlord with regard to relocation."

3. **When to Raise the Relocation Issue**

It would be prudent for landlords to reference relocation rights in their offers to lease. This could be as simple as including a statement to the effect that the tenant will sign the landlord's standard lease form and that the form will contain, among other provisions, a provision entitling the landlord to relocate the premises. A landlord who fails to address relocation rights at the offer stage may find itself barred from including a relocation clause in the formal lease document to be signed by the parties. In *Victoria Park Avenue Associates Limited Partnership v. Magnaflex Industries Inc.*⁴, the tenant signed a binding offer to lease for a five year term. The offer also provided that the tenant would sign the landlord's standard lease form within 30 days of its delivery by the landlord to the tenant. The offer did not contain a relocation clause although one was included in the landlord's standard form of lease. The tenant did not ask for a copy of the lease form prior to signing the offer. In that case, the Court held that the landlord breached the terms of the offer to lease by insisting on the inclusion of the relocation clause in the lease. In Court's view, the relocation clause was inconsistent with the terms of the offer insofar as the offer entitled the tenant to use and occupy a *specific* unit in the building for a five year term. (Fortunately for the landlord, the Court did not perceive the breach as being so fundamental as to entitle the tenant to terminate the lease).

4. **Negotiation Issues**

From a tenant's perspective, it is always preferable to remove a relocation clause from the lease entirely. If this is not possible, it is imperative for a tenant to negotiate protections for themselves in order to minimize or avoid any adverse consequences stemming from the relocation. In this regard, we have set out below some of the issues that arise during the course of negotiating relocation clauses. As a reference, we have appended sample "landlord" and "tenant" relocation clauses to this paper.

(a) Consent - Tenants often request that they be given approval or consent rights in connection with any proposed relocation. Landlords should be reluctant to grant this concession as it effectively denies the landlord of its "right" to relocate and simply leaves the landlord in a position to negotiate the relocation. If the landlord must give the tenant a right of approval, then the landlord should ensure that the lease specifically enumerates the entire scope of the criteria which a tenant is entitled to consider when faced with a request to relocate. The lease should also provide that the tenant must act reasonably in considering the criteria. Simply requiring the tenant to "act reasonably", without the necessity of having regard to any specific criteria provides the tenant with a great deal of

⁴[2000] O.J. No. 4725 (Ontario Superior Court of Justice, December 12, 2000, Sutherland J.).

discretion and leaves the tenant in a position to virtually nullify the landlord's relocation right.

(b) Notice Period - In negotiating the length of the notice period, a tenant must consider several factors including how much time it will require to: wind down its operation at its existing premises; prepare construction plans for the new premises; build-out the new premises (if not done by the landlord); and physically move from the existing location to the new location. A landlord, however, must keep in mind that it does not want to place itself in a situation where it loses out on a business opportunity because of its inability to obtain vacant possession within a reasonable amount of time.

(c) Reason for Relocation - In order to minimize the possibility of the landlord acting in a capricious or arbitrary manner, in the retail context, tenants may seek to limit the landlord's right of relocation to instances involving a major expansion, renovation or remerchandising of the shopping centre. Landlords should, of course, provide themselves with an unrestricted right to relocate the tenant or, at a minimum, ensure that its right to relocate is exercisable under a fairly broad set of circumstances.

(d) New Premises - This is arguably the biggest sticking point during negotiations. Tenants will want to ensure that the new premises are substantially similar in terms of size, configuration, visibility, exposure and mall frontage to the existing premises. Tenants may want to ensure a similar proximity to major tenants, mall entrances and escalators. Some tenants may also request that they only be relocated within a specific area or zone within the shopping centre. From the landlord's point of view, it is preferable for the landlord to avoid any representation in the lease with respect to the tenant's new space so as to ensure that it retains maximum flexibility. If the landlord must make some representations, it should only agree to relocate the tenant to new premises that meet certain *objective* criteria (i.e. size of the premises, frontage of the premises, and configuration of the premises). The use of *subjective* criteria (i.e. visibility, exposure and traffic) should be resisted as it gives the tenant room to argue.

Where a relocation clause specifies that the proposed new premises must be in a location "at least as good as the lease premises as reasonably determined by the landlord", case law has held that the landlord's determination must be one which might be reached by a reasonable landlord in the circumstances. Moreover, in these circumstances, the landlord is not required to be correct in its determination but, rather, the landlord must simply exercise a rational and honest judgment for the determination⁵.

(e) Costs of Relocation - Landlords generally agree to pay for the costs for removing the tenant's trade fixtures, equipment, inventory, and items of personal property from the old premises and installing them in the new premises. Landlords also generally agree to pay for the unamortized value of the tenant's leasehold improvements in the existing premises (to the extent that they have been paid for by the tenant and to the extent that they cannot be relocated or otherwise salvaged) as well as for the costs to construct the new premises so that they are comparable to the old premises. With respect to trade fixtures, landlords should agree to replace them only to the extent that they

⁵*C.T.R.E.F. Investment Ltd. v. H.G.O. Real Estate Ltd.*, supra note 2.

cannot be moved to the new premises. Some tenants, however, insist that the landlord provide them with new entirely trade fixtures.

Some tenants are also successful in negotiating that their landlords also pay the tenant's *indirect* costs associated with a relocation. These costs include such items as printing new stationery and business cards and advertising to inform the public of the tenant's new location. Strong tenants may also get landlords to pay for lost profits and continuing fixed overhead costs (i.e. salaries of full-time employees) during any down time. In all cases, in order to avoid disagreement and surprises, landlords should consider options such as placing a cap on recoverable relocation costs and should insist that the tenant provide copies of paid invoices for all costs to be reimbursed.

(f) Number of Moves and Time of Move - Given the significant disruptions that a tenant's business must endure during a relocation, tenants often ask that the landlord's right to relocate be restricted to a single move during the term of the lease. While landlords should generally avoid restricting their options in this manner, landlords might consider granting this concession for a lease of a short duration. For longer term leases, landlords may wish to consider limiting their right to relocate to once every specified number of years.

Tenants will also often require that any right to relocate not be exercisable during, for example, the first five years of the term (in order to establish their business in the shopping centre) or during the last eighteen months of term (in order to give themselves sufficient time to amortize its leasehold improvements). Similarly, tenants often ask that they not be relocated during any peak business seasons (such as Christmas, back-to-school, R.R.S.P. season, Mothers Day). While landlords should avoid restricting their flexibility, in situations where a tenant pays percentage rent, it may be in everyone's interest to avoid disrupting the tenant's business during periods of high sales volumes. Landlords should also have no objection to physically relocating tenants during non-business hours.

(g) Down-Time - Tenants may require that the relocation will not result in any down time to their business. Landlords may address this issue in a number of ways. For example, the landlord may agree that the tenant will not be required to relocate until the new premises are ready to be open for business. Alternatively, the landlord may agree to provide the tenant with temporary premises so as to avoid periods of closure. As a somewhat less favourable compromise, the landlord may agree to pay the tenant for its lost profits and fixed overhead costs during any period of down time. In this regard, should the landlord elect to pay such profits and costs, the landlord should attempt to cap any payout.

(h) Termination and/or Extending the Term - A tenant may seek to have the right to terminate the lease if it is not satisfied with the proposed relocated premises. Of course, as the landlord's business is based on the rents it collects, it should avoid giving the tenant the ability to walk away from its lease obligations. Sometimes the right of termination also extends to the landlord so that if there are no suitable alternative premises to which to relocate the tenant, the landlord may terminate the lease. In either case of termination, it is not uncommon for the landlord to reimburse the tenant for the undepreciated capital cost of the leasehold improvements paid for and installed by the tenant. In such a case, the landlord should ensure that the salvage value and the value of any

encumbrance is deducted from the undepreciated capital cost of the improvements. In addition, in order to avoid duplication of payment by the landlord, the landlord should also take into account any allowances or inducements paid by the landlord in connection with the initial installation of the leasehold improvements. To eliminate future disagreements regarding the cost of the leasehold improvements, both parties might find it beneficial to provide a value for the improvements in the lease.

A tenant may also request the option to extend the term for the relocated premises, particularly if the tenant is required to build-out its own space, so that it will be able to amortize the new leasehold improvements over a reasonable period of time. Similarly, if as a result of the relocation a tenant is required to shut down its business for an extended period of time, then the tenant may request that it have the option to extend the term of the lease by the corresponding time period. Extending the term in order for the tenant to make up for any down time is not normally a concession which is overly onerous for the landlord.

B. TENANT'S RIGHTS TO GO DARK AND LANDLORD'S RIGHTS TO RECAPTURE

1. Generally

From a landlord's perspective tenants should be required to continuously operate their businesses from their premises. Tenants, arguing that they need flexibility, resist operating covenants, but if unsuccessful in eliminating them entirely sometimes reach a compromise with their landlords through the negotiation of go dark rights. Under these clauses a tenant may cease operating its business in its premises without constituting an event of default under the lease. Typically a tenant is permitted to cease operating its business but is obligated to continue to pay all rent and otherwise perform the terms of the lease. In order to exercise a go dark right the tenant should be obliged to give its landlord advance notice of its intention to close its business. Tenants argue that they must be able to maximize any exit strategy by moving quickly and without the obligation to advise their landlords of their intention. Tenants state that notice periods lead to, among other things, morale and staffing issues. However, landlords must be able to deal with vacancies, particularly those of key tenants; consequently, as much advance notice as possible of the exercise of a go dark rights should be sought by prudent landlords.

Care must be taken to consider precisely which events will trigger a go-dark right. From a tenant's perspective a renovation of the premises, a reduction in operating hours or operating in a reduced portion of the premises would not be events that are intended to lead to go-dark rights. Consequently careful drafting with regard to the events that constitute a go dark event is needed.

On the other hand, faced with a non-operating tenant, landlords will want to limit a tenant's special rights granted under a lease. For example, when a tenant ceases to operate a landlord may want to rescind that tenant's renewal rights, expansion rights, exclusive rights, no build restrictions and options to purchase.

Furthermore, if the lease includes a go-dark provision, then landlords should insist on obtaining

a corresponding right, at the landlord's option, to "recapture" the premises if the tenant ceases to operate its business. In essence, a recapture right allows a landlord to terminate the lease and take control of the premises in order to relet those premises to a new tenant.

From a landlord's perspective, recapture rights are extremely important as they assist the landlord in minimizing damage to the image and profitability of the shopping centre. Tenants, on the other hand, are somewhat divided on whether they are agreeable to the inclusion of a recapture right in their leases. Some tenants are reluctant to provide a landlord with recapture rights as they fear they will lose business if the landlord re-lets the premises to one of the tenant's competitors. Other tenants however, do not oppose the inclusion of recapture rights particularly if the recapture right brings their lease commitments to an end.

2. Points of Contention In Negotiating Recapture Rights

We have set out below some of the more contentious issues which arise during the course of negotiating a landlord's right of recapture. For reference, we have attached sample "landlord" and "tenant" recapture clauses.

(a) **Waiting Period** - One issue concerns the amount of time that must elapse before the landlord may exercise its right of recapture. As the landlord's goal is to minimize damage to the shopping centre, the landlord will want any waiting period to be as short as possible. Accordingly, the landlord may insist on a right of recapture that is exercisable immediately upon receipt of the tenant's notice of its intention to go dark. Tenants, however, may want the waiting period to be as long as possible in order to give themselves maximum flexibility. An extended waiting period allows the tenant more time to negotiate an assignment or sublease *with a tenant of its choice* and it also allows the tenant the possibility of re-opening for business should market conditions improve. Regardless of the length of the waiting period, landlords should ensure that the waiting period does not begin to run anew if the tenant decides to open for a few days within the waiting period.

(b) **"One-Time Only" or Continuous Right** - Another issue often negotiated between the parties pertains to whether the landlord's right of recapture must be exercised within some stated time after the tenant goes dark or whether the landlord's right to recapture is a continuous right. A continuous right to recapture may be exercised at any time by the landlord if the tenant is not operating its business in the premises. Uncertain of what opportunities may or may not lie ahead, landlords should insist on a continuing right of recapture so as to maintain their ability to adapt to changing circumstances.

(c) **Tenant's Right to Nullify** - Tenants sometimes ask for the right to nullify the landlord's exercise of its right of recapture in certain circumstances. In this scenario if the landlord gives the tenant notice of its intention to recapture the premises, the tenant may elect to rescind its decision to go dark and the tenant's original go-dark notice is deemed null and void. This right to nullify effectively provides tenants with the ability to "test the waters" in instances where they wish to go dark but, for various reasons, they do not want the landlord to recapture the premises. If the landlord is agreeable to giving the tenant a right to rescind its notice, the landlord should ensure that the

tenant is obligated to respond within a reasonable period of time after the landlord's election. Landlords may also wish to consider limiting the availability of the tenant's right to nullify to a "one-time only" so that as a condition of issuing the notice to nullify the landlord's recapture right the tenant is required to thereafter actively and continuously operate in the premises. Limiting the right to rescind in this matter is of benefit to the landlord in that it is not faced with a tenant who continually opens and closes the premises.

(d) **Payments Made Upon Recapture** - Upon the landlord's exercise of its right to recapture, the landlord will require the tenant to reimburse the landlord for the unamortized cost of any leasehold improvements paid for by the landlord as well as for the unamortized amount of any tenant allowance or inducement paid to the tenant. From the landlord's point of view, the early termination has prevented the landlord from fully recouping its investment in the tenant's operation. Tenants, on the other hand, will want the landlord to reimburse them for the unamortized cost of any leasehold improvements paid for by the tenant as well as for the unamortized cost of any trade fixtures or equipment that the tenant is not able to remove or otherwise salvage from the premises. This issue is resolved by which party has the greater bargaining power.

(e) **Restrictions on the Landlord's Ability to Re-Lease the Premises** - A tenant may agree to give a landlord a recapture option provided the landlord agrees not to re-let the space to one of the tenant's competitors or alternatively if the landlord agrees to restrict the use that can thereafter be made of the premises. Understandably landlords are very reluctant to consent to this restriction - if the tenant is not using the space, why should a landlord's leasing efforts be restricted? However, if pressed, a landlord might agree to restrict its ability to re-let the premises provided the restriction is subject to one or more of the following conditions:

- (i) the restriction will not apply unless the tenant opens a new store within a set radius of the shopping centre; obviously a tenant who opens fifty kilometers away does not have a need for protection from a competitor;
- (ii) the tenant must open its new store within a set amount of time; a landlord does not want to be put into a position where the tenant mulls over the idea of opening a new store for several years; and
- (iii) the restriction on re-letting should only apply for a set number of years.

Of course, landlords must also ensure that the restricted use or the tenant's "competitors" are narrowly defined.