Whose Form Is It Anyway?

When Using the Tenant's Lease Form, the Points Do Matter!

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Veterans of the Canadian commercial leasing industry may remember the days when lease negotiations began simply enough on the landlord's standard form. This is not to say that it was unheard of or unusual for a tenant to request that its own form be used, but with few exceptions, the norm would be for the lease to be prepared on the landlord's form for the property in question. These days, though, it is becoming increasingly more common for parties to agree to begin negotiations on the tenant's field – that is, more and more, landlords are being faced with having to use the tenant's standard form of lease. This movement can be attributed in part to the desire of these landlords to attract the growing number of American retailers that have decided to make the trek northwards. Unlike in Canada, where negotiating power has traditionally rested in the landlord's hands, American retailers have long enjoyed a retail landscape that favours the tenant, and now often insist on using their own lease form. What's more, and in particular with American retail tenants, these deals often begin with the tenant's form of letter of intent, which, unsurprisingly, is tailored specifically to serve the wishes of the tenant. To the landlord's further frustration, tenants will often stick fervently to the terms of the letter of intent in its favour, zealously resisting the landlord's attempts to improve its own position come the lease stage. But in the same breath, these tenants will maintain that those terms of the letter of intent in favour of the landlord were meant to be clarified at the lease stage to match the tenant's form.

For some time, the trend of using the tenant's form of lease seemed to be contained within the sphere of anchor tenants who, to some extent, already had the negotiating clout to call some of the shots. Similarly, it was generally restricted to the retail field, since many of the issues that tend to crop up between landlords and tenants (for example, continuous operating provisions, co-tenancy rights, and exclusivities) tend to be less contentious in the office and industrial leasing context. Increasingly, though, this trend continues to spread and has surfaced in negotiations across the gamut, from major anchor tenants down to 3,500 to 5,000 square footers. It is also not unheard of for office or industrial tenants to push their own lease form depending on the nature of their operations (a bank tenant or insurance firm with multiple locations, for example, might prefer to achieve consistency in the management and operation of their various offices and consequently push to start with their form of lease). Particularly in the context of what has sometimes been referred to as a "tenant's market" in the last few years, the

shift in bargaining power has seemed to favour the tenant's side, and more and more tenants have been able to win on this point.

What's the Rationale?

The tenant's desire to use its own lease form stems from the same rationale as that of the landlord. Ultimately, both parties are seeking two things: efficiency and leverage. Tenants who operate numerous locations in various jurisdictions argue that they cannot undertake the administrative burden and additional costs incurred in managing a different lease form for each of its locations. Additionally, both parties believe that using their own lease form provides an advantage when it comes to negotiating the nitty-gritty, not only due to familiarity with the form, but also due to the shifting of the burden of negotiating in favourable terms onto the other party. The desire to set the tone for negotiations and, largely, to control the conversation is powerful, and so parties sometimes labour the question of whose form should be used. Given that both parties have a legitimate interest in starting with their own lease form, the determining factor will come down to which party has the greatest bargaining strength. Landlords faced with accepting a desirable tenant's LOI and lease form should remain acutely aware that the field will start heavily skewed to the tenant's advantage. However, with adequate guidance, landlords should be able to find themselves with a negotiated form that they can live with.

Major Sticking Points

Perhaps in an effort to attract tenants in a tenant-friendly market, developers have lately become more and more creative in the arrangement of retail centres, ranging from mixed office/retail/and residential projects, to complex combinations of multi-level enclosed and free-standing structures. Correspondingly, landlord's standard lease forms for these unique projects have become more and more specialized, accommodating for the varying rights and interests at play in these complex lifestyle-oriented centres. In this context, it is no wonder that a landlord would prefer to begin with their tailored lease forms. Still, in order to attract desirable tenants, some landlords will be willing to work with the tenant's form, and so, in addition to the various interests that must be accommodated for according to the particularities of each centre, landlords should also turn their minds to a number of important provisions to ensure that they continue to meet the landlord's reasonable needs. The balance of this article will

summarize these important provisions and provide an overview of the points that landlords need to consider and be wary of.

Use Restrictions

One of the most important provisions in a retail lease is the permitted use clause. For the landlord, maintaining a firm grip on the scope of the tenant's activities within the premises is critical not only to maintaining a well-balanced and attractive merchandising mix in the overall project, but also to ensuring that the landlord does not run afoul of exclusives or restrictive covenants granted to other tenants of the development. Tenants, on the other hand, would far prefer to keep their use clause as broad as possible to allow its business to grow and evolve in its practices, as well as to have flexibility in transferring the premises to another party if it so chooses. As such, a tenant's starting point may be to grant itself the right to operate "any legal use" in the premises, while the landlord would prefer to set out, as narrowly as possible, the exact nature of the tenant's business. The tenant's permitted use is a fundamental provision typically negotiated at the preliminary document stage, even in cases where the parties' starting point is a simple non-binding letter of intent. However, in those circumstances where the parameters of the use clause are not clearly set out prior to the lease drafting stage, the landlord will likely find that the tenant's form of lease provides a broad use clause and flexibility to change the use without the landlord's consent. In such cases, at a minimum, the landlord should be careful to require that the tenant abide by any existing restrictive covenants granted to other tenants, and if possible, allow itself the ability to add to the list any restrictive covenants it grants to other tenants in the future to the extent such new restrictions do not curb the tenant's then-current business operations.

Operating Costs

Regardless of whose standard lease forms the basis for negotiations, operating costs are more often than not ripe grounds for disagreement. While experienced parties will expect some amount of push-back on particular inclusions, landlords should be careful to note whether the definition of operating costs itself is expressed as being inclusive (using language such as "Operating Costs will include, *without limitation*, the following items…"), or exhaustive. Failure to do so could severely impair the landlord's ability to recover reasonable costs incurred in maintaining and operating the centre. Correspondingly, attention should be paid to whether the tenant's

proportionate share is to be calculated without exclusions to the denominator, and whether any limits exist on the landlord's ability to allocate certain costs across the development or to gross up the tenant's share to reflect vacant premises that were not excluded from the proportionate share calculation. Landlords who give up these rights risk having to absorb costs attributable to vacant premises and losing the right to distribute certain expenses more equitably across the development. . It goes without saying that a tenant's form of lease will not include these landlord-friendly features, and often they are not on the table or discussed during negotiations of the business terms of the dealt at the preliminary lease document stage. As a result, landlords may be faced with an uphill battle trying to build these features into the tenant's form of lease during lease negotiations.

Tenant's Business Operations

A contentious issue that often arises between parties is the tenant's ability to "go-dark". The landlord ideally wants all tenants to be open and operating during all of the centre's hours (and *only* during those hours). The tenant's interest lies in maintaining as much flexibility in the manner of its business operations, including the ability to operate during the hours it chooses or to cease operating altogether. As such, landlords should not be surprised to receive a lease form which omits any type of operating covenant or landlord recapture right (effectively allowing the tenant to close shop for as long as it wishes during the term of the lease, all without penalty). If faced with a particularly strong or desirable tenant, landlords may try to impose a limited continuous operating covenant (for example, during the first few years of the term) and/or include a recapture right (allowing the landlord to retake possession of the premises if the tenant remains dark for a prescribed period of time). It is important to keep in mind that without such a recapture right, one premises going dark (particularly if it is a significant or anchor tenant) could be the trigger for a larger problem: other tenants with co-tenancy rights may become entitled to certain rent abatement rights or even to go dark themselves, contributing to a domino effect in the centre and resulting in a negative impact on all other tenant's businesses and on the overall reputation of the development.

Landlord's Remedies on Default

A tenant's standard form is likely to impose limitations in its tenant default provisions, including setting out relaxed cure periods, minimal (if any) automatic default circumstances, and possibly even waivers of the landlord's re-letting, distraint, and termination rights in the event of default. With respect to American tenants, it should be

noted that in many American states there is no legal right for a landlord to distrain on the tenant's property in the event of a default (though other statutory lien rights might exist). As a consequence, due to their unfamiliarity with this Canadian common law right, American tenants may bristle at the introduction of provisions dealing with the landlord's right to distrain upon the goods in the premises. Further, given the largely tenant-friendly environment they are coming from, American tenants may also try to control the ways in which landlords may exercise their remedies (for example, some tenants may try to require landlords to sue monthly for rent as it becomes due, or may even insist on the landlord obtaining a court order before being in a position to terminate the lease, regardless of the default). Whether dealing with an American or major domestic tenant, landlords should pay particular attention to the default and remedy provisions contained in a tenant form of lease, as they will likely fall far short of the more exhaustive and stricter list of defaults and remedies that landlords are used to seeing.

Tenant's Remedies

In addition to restricting the landlord's remedies on default, the tenant's lease form will most likely also expand the types of remedies available to the tenant upon the landlord's default. These remedies could range from rights of set-off, rent abatement, and even termination rights. For example, where a landlord fails to make certain required repairs to common elements, the tenant's lease form may provide a "self-help" right allowing the tenant to undertake the work itself, and set off against rent any amounts incurred in the performance of such work. More drastic provisions may allow a tenant to terminate its lease where visibility of or access to the tenant's premises is compromised. While a landlord's initial position would be to eliminate these rights entirely, some concession may be required when dealing with a particularly strong or desirable tenant. In those circumstances, landlords should seek to build in a lengthy notice and cure period to each of these tenant self-help rights, requiring the tenant to allow the landlord the opportunity to cure any breaches before allowing the tenant to exercise its rights. Landlords should also ensure that the tenant's self-help remedies only apply with respect to a landlord default which actually impacts the tenant's premises or the tenant's ability to conduct its business from its premises, otherwise tenants may be granted disproportionately powerful remedies in response to relatively harmless defaults of the landlord.

Insurance

It should come as no surprise that the insurance section of a tenant's lease form might seek to minimize the amounts and categories of insurance that the tenant is required to undertake and maintain. Similarly, these provisions will likely stay silent on any obligations to add the landlord as an additional insured or loss payee, effectively excluding the landlord from participating in the settling of a claim and receiving proceeds directly in its name in the event of a payout. At the very least, landlords should be careful to inserts waivers of subrogation by the tenant's insurer in the landlord's favour, and releases by the tenant of the landlord in respect of any loss or damage against which the tenant is required to be insured, so that these mirror those waivers and releases likely granted in the tenant's favour. Additionally, there should be remedies built into these provisions for circumstances where the tenant has failed to insure in accordance with the requirements of the lease, such as allowing the landlord to obtain the insurance on the tenant's behalf and at the tenant's cost.

In some cases, particularly for tenants with significant covenants, the lease form may state that the tenant is entitled to self-insure. While it is not uncommon for landlords to agree to this sort of arrangement with large, established entities, landlords should in each instance turn their minds to whether they are comfortable with relying on the tenant's covenant for such coverage, and whether they are agreeable to allowing the tenant to self-insure with respect to both property and liability matters.

Assignment, Subletting, and other Transfers

Because the ability of a tenant to transfer the lease is critical to maintaining flexibility in its business practices, the tenant's standard transfer provisions will likely contain a number of "no-consent" transfer rights and omit any general prohibition on transfers without the landlord's consent. Even if these provisions do include circumstances requiring the landlord's consent, the grounds on which the landlord may make a determination (such as the proposed transferee's financial covenant and business history) will likely be sparse, and, as the tenant's interest is in keeping its costs low, will likely remain silent on the landlord's ability to recover any legal or administrative costs incurred in connection with its consent to the transfer. Unless particular provisions are inserted to account for these items, the landlord will be hard-pressed in objecting to a transfer or recouping any associated costs incurred by it.

Damage and Destruction

It lies in a landlord's best interest to have as much consistency as possible across all leases in a particular development in the provisions dealing with the consequences of significant damage to or destruction of the premises or the development. While landlords are sometimes willing to negotiate certain step-downs to these provisions for important tenants, it is critical that the thresholds for termination in the event of such damage or destruction are more or less the same throughout the property. Otherwise, in the event of significant damage, landlords risk finding themselves able to terminate the bulk of the tenants, but having their hands tied with respect to a few holdouts, hindering the landlord's ability to demolish and rebuild or otherwise deal with or dispose of the property.

Jurisdiction

In addition to the considerations outlined above, there are a number of significant ways in which the standard form of an American tenant might be tailored to respond to the American legal system which might not translate appropriately in the Canadian context. For example, while Canadian bankruptcy proceedings might have an overall analogous intent and effect to those contained in the U.S. Bankruptcy Code, there are a number of important technical differences between the regimes, and any particular references to the Code should be carefully amended to refer to the analogous provisions in the Canadian statutory scheme. Similarly, as the American legal system has only broad legislation dealing with expropriation (American "eminent domain" rights stem from the United States Constitution), it is not uncommon to see extensive provisions in American tenant lease forms dealing with the consequences of a government taking. In Canada, however, comprehensive legislation exists at both the provincial and federal levels dealing with the manner and consequences of such a taking, making much of the detailed and complex approach to expropriation typically found in American tenant lease forms unnecessary in the Canadian context.

American lease forms may also be critically deficient in responding to the Canadian legal landscape due to an absence of similar restrictions or requirements in the American legal system. For example, in Ontario, a violation of *Planning Act* provisions can have a drastic impact on the validity of a lease. A lease in excess of 21-years must fall within one of the stated exceptions under the Act, or risk being considered to be ineffective in its entirety. To protect against such a drastic consequence, it is very common for Ontario leases to contain a standard clause stating

that in the event of a violation of a *Planning Act* requirement, the lease will be deemed to be for a term of "21 years less one day". The absence of such a clause is harmless in an American jurisdiction where no such statutory restriction exists, but potentially devastating in the Ontario system.

A Note on Drafting Considerations

For landlords who find themselves grappling with a tenant's lease form, it is important to remember that shaping the lease into something a little more landlord-friendly cannot be accomplished by simply cutting and pasting from the landlord's standard form. Though the landlord is certainly entitled (and encouraged) to draw from its experiences using its own form for guidance on how certain provisions might be reasonably negotiated, drafters must be careful to maintain consistency and logic in the overall agreement. The mechanical process of cutting large passages from one form and inserting them into another risks creating uncertainty of rights and obligations and possibly resulting in issues of interpretation (and related litigation) in the future, in turn souring the landlord and tenant relationship. As such, great care should be taken in weaving important concepts from the landlord's form into the tenant's form.

Conclusion

Ultimately, neither the landlord nor the tenant have an objectively more persuasive reason to force their standard form as the basis for the lease – both parties benefit similarly in having consistency among the various leases that they administer. Given that most landlords and tenants in this context are likely to be sophisticated business parties, however, the question of the leverage to be obtained in beginning with one's own standard form may be overcome with adequate legal guidance. Similarly, as many deals will begin with an offer setting out the major business points, some of the considerations outlined above may be more or less relevant. In the end, with the proper guidance, landlords who agree to use the tenant's form of lease should be able to negotiate reasonable compromises to end up with a sort of "hybrid" form of lease that they can live with, incorporating concepts from both landlord-friendly and tenant-friendly forms – though it may just take some extra time and costs to get there.