

May 23, 2013

The Perils of Mixed-Use Condominium Developments for Commercial Tenants

From a commercial leasing standpoint, tenants of mixed-use condominium developments face a unique and interesting set of challenges. The recent decision of the Ontario Court of Appeal in *Toronto Standard Condominium Corp. No. 1633 v. Baghai Development Ltd.* highlights one such challenge: achieving harmony between lease terms and condominium documents.

In *Baghai*, the tenant was a chain convenience/grocery store operator who leased ground floor space from a high-rise residential condominium developer. The lease agreement was entered into prior to the erection of the condominium and before the condominium documents were finalized. (*A condominium comes into existence when the condominium declaration, description and bylaws are registered on title to the property.*)

In *Baghai*, the tenant registered a notice of its lease on title to the land before the condominium documents were in place. The lease granted the tenant a licence to use the exterior sidewalks for the display of fresh fruits, vegetables and other seasonal items. The notice registered on title included the tenant's right to use the sidewalk area for display purposes.

The lease stated that the developer/landlord would ensure that (1) the condominium declaration and by-laws would preserve and not conflict with the lease, and (2) the tenant's right to use the sidewalk area for display purposes would be incorporated into the condominium documents.

Alas, the developer/landlord did not meet those obligations: the tenant's right to sidewalk displays was omitted from the condominium declaration and by-laws. The declaration and by-laws actually restricted the common elements (including the sidewalks) from being "obstructed by any of the owners or used for any purpose other than for ingress or egress to and from their respective units."

The tenant used the outdoor sidewalk display for 4½ years. Then, the condominium corporation brought a court application against both the developer/landlord and the tenant for removal of the displays. It claimed that the fruit stands (located on the

common element sidewalks) breached the condominium's declaration and by-laws.

The tenant countered that its notice of lease was registered on title ahead of the condominium declaration and by-laws, such that pursuant to the *Land Titles Act*, the condominium declaration and by-laws were subject to the tenant's pre-existing rights.

The Ontario Superior Court ruled that the provisions of the *Condominium Act* trumped the *Land Titles Act*. It further held that although the notice of lease was registered on title, the lease was a private arrangement between the developer/landlord and the tenant and that since the developer/landlord failed to include or protect the tenant's sidewalk display right in the condominium documents (which it could have done by including the rights in the condominium declaration and by-laws), the developer/landlord could not impose its private arrangement with the tenant on the condominium corporation and the unit owners. The Court ordered the tenant to remove its displays. The Court of Appeal upheld the ruling.

The *Baghai* decision highlights the difficulties faced by tenants of mixed-use condominium developments. From a leasing perspective, the tenant did what it could to preserve its display rights in the common elements. The tenant had a lease in which the developer/landlord covenanted to ensure that the tenant's lease rights would be protected by the condominium documents.

Unfortunately, the developer/landlord did not honour that obligation. The tenant's recourse (a claim for damages) would be against the developer/landlord - but from its perspective as a user, no amount of money could fairly compensate the tenant for its loss of street presence and appeal.

Baghai is not merely a cautionary tale to tenants of mixed-use condominium space, reminding them to check that the underlying condominium documents support their lease rights. Unfortunately, *Baghai* also stands as an example of how competing legislation can protect consumers ahead of commercial enterprises.

The *Land Titles Act* was designed to prevent acquirers of an interest in lands from denying the existence of prior registered rights. But Section 2(3) of the *Condominium Act* states that it governs once the declaration and description are registered. It is also important to note that, if the draft condominium declaration and by-laws disclosed in a selling package to condominium buyers failed to mention commercial tenant rights, a subsequent, material modification to that disclosure package would entail permitting buyers to withdraw their commitment. (To be clear, it is not known, nor is it suggested here, that this had any bearing on *Baghai's* failure to disclose the tenant's fruit stand rights.)

Considering that a tenant cannot protect itself by recording its lease rights relating to the condominium common elements in the condominium documents themselves, but must depend on the developer/landlord to do so, tenants of condominium premises must be creative and vigilant to ensure that the condominium corporation does not take away valuable lease rights.

In the case of an existing condominium, tenants are well advised to study the declarations and by-laws to ensure that lease rights will be permitted. A tenant may well condition its commitment on an amendment to the by-laws, ensuring the rights it bargained for. It may even stipulate remedies to guard against future changes to the by-laws that would contradict the lease terms.

But where a tenant's lease predates the registration of the condominium declaration and involves rights that depend on the support of the condominium corporation, it may wish to consider the following:

1) require as a lease term that the landlord/developer, at its cost, provide all

approvals required from the condominium corporation regarding the tenant's proposed use of the premises/common elements, as well as delivery of proof to the tenant prior to taking possession of the premises, with failure triggering a right to terminate the lease with reimbursement by the landlord of all costs incurred by the tenant in the lease transaction;

2) require the developer/landlord to designate, in the condominium declaration, a portion of the common elements as an "exclusive use common area" to be used as contemplated by the lease. (Exclusive use common areas are governed by Section 98(2) of the *Condominium Act*);

3) include in the offer to lease/lease: (i) a right to review the draft condominium declaration before registration; and (ii) an early termination right or rent reduction if the developer/landlord fails to include the tenant's use rights in the condominium declaration; and

4) obtain an indemnity from the developer/landlord for any claims, losses or damages resulting from any inconsistency between the lease and the condominium declaration.

It must be noted that the above rights may be hollow, if the tenant does not enforce its rights when the developer/landlord does not meet the requirements, or if damages are difficult to quantify, or if the landlord's covenant in support of the indemnity is inadequate to meet the exposure. Moreover, condominium corporations have been known to change their declarations and by-laws by passing resolutions with the requisite level of votes of unit owners.

Commercial condo tenants, beware!



Our secret for closing files lies as much in what is taken out as in what is put in. By eliminating exorbitant expenses and excess time, by shortening the process through practical application of our knowledge, and by efficiently working to implement the best course of action, we keep our clients' needs foremost in our minds. There is beauty in simplicity. We avoid clutter and invest in results.

Often a deal will change complexion in mid-stage. At this critical juncture, you will find us responsive, flexible and able to adjust to the changing situation very quickly and creatively. We turn a problem into an opportunity. That is because we are business minded lawyers who move deals forward. The energy our lawyers invest in the deal is palpable; it makes our clients' experience of the law invigorating.

MARY ANN BADON
416-598-7056
mbadon@dv-law.com

FRANCINE BAKER-SIGAL
416-597-8755
francine@dv-law.com

JEANNE BANKA
416-597-0830
jbanka@dv-law.com

CANDACE COOPER
416-597-8578
ccooper@dv-law.com

DENNIS DAoust
416-597-9339
ddaoust@dv-law.com

BITALI FU
416-598-7053
bitalif@dv-law.com

GASPER GALATI
416-598-7050
ggalati@dv-law.com

S. RONALD HABER
416-597-6824
rhaber@dv-law.com

WOLFGANG KAUFMANN
416-597-3952
wolfgang@dv-law.com

LYNN LARMAN
416-598-7058
llarman@dv-law.com

MIMI LIN
416-597-8493
mimil@dv-law.com

MELISSA M. MCBAIN
416-598-7038
mmcbain@dv-law.com

JENNA MORLEY
416-597-9225
jmorley@dv-law.com

JAMIE PAQUIN
416-598-7059
jpaquin@dv-law.com

PORTIA PANG
416-597-9384
ppang@dv-law.com

ALICE PERALTA
416-597-1536
aperalta@dv-law.com

KENNETH PIMENTEL
416-597-9306
kpimentel@dv-law.com

NATALIE VUKOVICH
416-597-8911
nvukovich@dv-law.com

DEBORAH A. WATKINS
416-598-7042
dwatkins@dv-law.com

