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PROPERTY
– Leasing Update

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Good Business Sense

By Lisa A. Borsook and Benjamin H. Wong

"Latent Ambiguity" and Good Business Sense

The Ontario Superior Court of Justice and Court of Appeal's recent decision in *Calloway Reit (Westgate) Inc. v. Michaels of Canada, ULC* ("**Calloway**") is a shot across the bow for tenants seeking to avoid rent when in possession of the premises, open for business and accepting the services of the landlord. Calloway suggests that the courts are unafraid to use the tools of contractual interpretation to arrive at a result that makes sense and ensures a fair result. Landlords and tenants, particularly sophisticated entities, should carefully consider industry standards and past conduct before pursuing a contentious course of action and relying solely on their lease. In this case, the courts clearly held no sympathy for the tenant seeking to completely avoid its obligation to pay rent nearly 1½ years after taking possession and operating on the premises.

The Facts of Calloway

The parties entered into a shopping centre lease on December 19, 2005 (the "**Lease**"). On July 5, 2007, Michaels of Canada, ULC (the "**Tenant**") took possession of the premises and opened for business but did not pay rent. Calloway REIT (Westgate) (the "**Landlord**") commenced this action on November 21, 2008, as a result of the Tenant's continuous refusal to pay rent.

The Lease (the Tenant's standard form) provided that rent accrued from the rental commencement date, which could not occur until the Landlord fulfilled its construction obligations in accordance with the completion date. The Tenant took the position that this meant all buildings in the shopping centre had to be constructed before rent was owed. As at November 2008, the shopping centre was 90% complete.

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At first instance, the application judge engaged in a factual analysis to determine the "general context that gave birth to the document". The court concluded that the interpretation argued by the Tenant did not accord with good business sense for several reasons. First, the Tenant was aware that the shopping centre was proceeding as a phased development project. Moreover, under the Lease, Wal-Mart was the only tenant that was required to be open for business as a condition of the Tenant's obligation to pay rent. Second, nine previous leases negotiated by the Tenant, in respect of phased development projects, contained the same provisions – but the Tenant had commenced paying rent for those premises, well before all of the buildings in those respective shopping centres were fully built out. Third, the judge found internal inconsistencies within the Lease that favoured the Landlord's interpretation that the shopping centre need not be fully constructed to trigger the Tenant's rental obligations. The application judge then aptly highlighted the absurd practical effect of the Tenant's position that, if allowed, would permit it to "occupy the Premises, rent-free, until the Shopping Centre is fully completed, despite itself being fully operational . . .".

The Court of Appeal Decision

In a unanimous decision, the Court of Appeal dismissed the appeal and ordered costs against the Tenant. Unlike the lower court, the Court of Appeal resolved the issues on appeal using contract interpretation principles alone. The Court of Appeal accepted the application judge's finding of internal inconsistencies within the Lease and invoked the doctrine of "latent ambiguity" to put the matter at an end. The doctrine, briefly stated, requires that an interpretation of an agreement must accord with good business sense, and avoid commercial absurdity. The ambiguity is latent because it is usually not obvious on the face of the document, and only arises when there is conflict with the evolving factual circumstances. In applying the doctrine, the Court of Appeal determined that it was not commercially reasonable to interpret the completion date and rental commencement date in such a way that would allow the Tenant to take possession, carry on business, and avail itself of the common elements and other services of the Landlord, but not pay rent. The Court of Appeal went on to conclude that the Tenant's conduct in the circumstances effectively waived strict compliance by the Landlord with its construction obligations as a condition triggering the Tenant's rent obligations.

Waiver and latent ambiguity – tools to think about when you don't like what the contract has to say.

Rooftop Solar Panels – Good Business Sense or Not?

By Lisa A. Borsook and Jeff G. Cowan

A number of landlords, owners and tenants have recently received inquiries from rooftop solar panel installers, desirous of installing solar panels on their roofs. In principle, the idea sounds like a good one, encouraging green initiatives. But in circumstances in which the owner is not the end user of the building (it has a tenant) or is thinking of selling the building, further consideration may be required before entering into licences for solar panels.

The first consideration has to be whether or not the landlord, owner or tenant in fact controls the roof at all. In ground leases, the landlord leases the entire property and building to the tenant and, as such, it is the tenant and not the landlord that has control of the roof. In a single tenant building, it may be that the landlord has offloaded the responsibility for the roof to the tenant. Alternatively, the lease may allocate obligations in respect of the roof between the landlord and the tenant. It may be that the tenant has the day-to-day repair and maintenance obligations in respect of the roof, and that the landlord's obligations are limited to capital costs associated with the roof. It may be that the landlord keeps all of the roof obligations, but offloads certain of the costs it incurs to the tenant. The lease may

create a distinction depending on whether or not it is the structural or non-structural portions of the roof being considered. Suffice to say, the first step in any discussion of whether or not to license the roof for the use of solar panels is to take a look at the leases affecting the building to determine how the costs are allocated between the landlord and the tenants with respect to the roof, and whether or not any licence fees earned by the landlord or the tenant in respect of the solar panels need to be attributed against other operating costs or are for the landlord's or tenant's account alone.

It is also critical to examine any reciprocal operating agreements or agreements with "shadow anchors", which might limit rooftop use or require certain equipment to be screened from view (which could hamper the operation of the panels), and which might prescribe maximum building heights (which heights are perhaps affected by rooftop installations).
The next step is to take a good, long look at the licence itself. A landlord or owner wants to consider not only where the panels will be located, but also their weight and impact on the roof, the allocation of responsibility for maintaining, repairing, upgrading (as the technology evolves), replacing, and insuring the panels, relocation rights, and relocation costs. An owner/landlord needs to think about who is responsible for the removal of ice and snow beneath the panels, where the wires affecting the panels are going to go, whether or not the installation of the panels will affect any existing warranties or guarantees, or any signage, dedicated HVAC, telecommunication or satellite rights granted to others. One should consider whether or not the installation of the panels will affect other utilities in other premises, and who will be entitled to the benefit of the carbon credits that might be associated with the panels. It should be ascertained whether any hazardous substances are involved. Both parties will want to consider whether or not the licence, which is usually for a long period of time, is one that can be terminated, or one that must be assumed by a transferee. It is also important for an owner to be satisfied with respect to the financial wherewithal of the licensee and whether or not the licensee is a newly incorporated shell, or an entity that can live up to its obligations under the licence for the long term – and whether or not the licensee is entitled to transfer those obligations to another party with or without discussion with the landlord.

Finally, consideration needs to be given to the property tax implications. The panels and the foundations on which they rest would be exempt in proportion to that used for producing power for sale to the general public. While not exempt if the electricity is not used for sale, but for property use, an income property should not face any additional taxes if powered by in situ generators. An industrial building, generally valued on cost, has its building HVAC/electric

WORD OF THE DAY

CLEANTECH

A group of emerging technologies and industries that seek to manage environmental issues before they occur, based on principles of biology, resource efficiency, and second-generation production concepts in basic industries, and including the sectors of solar energy, biofuels, transportation and wind. Often contrasted with "green tech" or "envirotech", traditionally older technologies based on management of environmental issues after the problem has occurred (i.e., cleanup technologies).

systems costed – so, to the extent that the cost of a solar electricity system varies significantly from traditional systems, there may be some additional value.

Provincial assessors ("**MPAC**") currently treat the land on which panels and their foundations sit as being in the industrial tax class, which usually attracts a higher tax rate than the commercial class. However, that assumes the only use of the property is a solar electricity production facility. Land (which includes buildings and structures) that is used to produce electricity is classed as industrial.

It is not clear if MPAC would apportion, as industrial, any of the assessed value of, for example, a grocery store, the roof of which had solar panels.

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