



Demystifying the Commercial Lease Agreement

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TOPICS

1. The Commercial Lease Agreement
2. Common Clauses
3. Other Important Lease Provisions
4. Questions



The Commercial Lease Agreement



Complex Commercial Agreement

- Triple Net Lease
- Gross Lease
- Hybrid

What type of lease/property are we dealing with?

Retail	Industrial
Office	Other

What is the proposed use?

- The type of premises involved and the proposed use will impact what provisions of the commercial lease agreement will be of greater importance.

Lease Documentation

- Lease Agreement
- Offer to Lease
- Indemnity / Guarantee
- Extension Agreement
- Amending Agreement
- Assignment Agreement
- Relocation Agreement
- Surrender Agreement
- Lease Termination Agreement
- Consent to Change of Control

Offer to Lease



Very Important!

Common Clauses in a Commercial Lease Agreement



- ① Definitions
- ② Use
- ③ Radius Restriction
- ④ Term (Option to Extend / Option to Renew)
- ⑤ Relocation
- ⑥ Insurance & Liability
- ⑦ Subordination, Attornment & Tenant Security
- ⑧ Assignment / Subletting / Change of Control
- ⑨ Default
- ⑩ Environmental

1 Definitions

- ▶ Often overlooked, but are extremely important
 - Provide framework for remainder of lease.

Common Definitions

Gross Revenue

Important where tenant is responsible for payment of percentage rent. If acting for tenant, need to ensure proper deductions are included.

Operating Costs

Landlord will want to ensure that this definition is drafted broadly in order to allow it to pass off costs to tenant. If acting for tenant, need to ensure exclusions are carved-out.

Taxes

Should exclude taxes which are personal to the landlord or related to the landlord's own business.

2 Use of the Premises

Tenant

Wants its use clause to be as **broad** as possible to give it the flexibility it needs – “any use permitted by law”.

Landlord

Wants a tenant’s use clause to be **narrow and specific** to prevent duplication and ensure that a variety of products and services are offered to customers.

- ▶ Challenge in today’s marketplace - Very rare that a store sells only one type of product
 - Emergence of junior department stores, grocery stores that also sell home products, discount retailers, etc.
- ▶ Continuous operation
- ▶ Alterations

3 Radius Clause (Retail)

Tenant

Should consider the effect of such clause on its future and current business.

- Future expansion plans?

Landlord

Should consider whether to include a radius clause in the lease (will depend on the uniqueness of tenant's business).

- ▶ If radius clause is included, tenant should consider requesting the following exclusions:
 - Stores already operating within the radius as of the commencement date ([must request this exclusion](#));
 - Time limit on radius restriction (e.g. first two (2) years of term); and
 - Limit to advertised name (important for multi-chain ventures).
- ▶ Err on side of caution when opening new store in face of radius.

4 Term (Option to Extend / Option to Renew)

Tenant

Should insist on including a right of extension – provides flexibility to tenant and its business.

Landlord

Should include language to provide it with the ability to increase minimum rent for extended term.

- BUT...agreement to agree language should be avoided.

- ▶ Option to **Extend** vs. Option to **Renew**
 - Tenant should insist on option to extend.
- ▶ Consider conditions for extension/renewal
- ▶ Continuing liability of tenant in case of assignment

5 Relocation

Landlord

Standard lease form will often include a right to relocate tenant.

- Highly contested lease provision

Tenant

Should attempt to delete, but if landlord insists it remain then additional language should be added to properly protect the tenant:

- Substantially similar size and configuration;
- Landlord to cover all reasonable costs of relocation;
- One-time right of relocation; and
- Tenant termination right.

Address in offer to lease (deal with this upfront...do not wait)

6 Insurance & Liability

Limitation on Liability

- ▶ Tenant should insist that landlord's negligence be excluded.

Release

- ▶ Tenant should ask for a mutual release.

Indemnification

- ▶ Landlord will often require an indemnity from the tenant.
 - Tenant should insist on a mutual indemnity (exclusions for negligence should be inserted).

Insurance

- ▶ Tenant should carefully examine the insurance provisions in lease.
 - Insurance brokers and consultants should be consulted in order to ensure that the tenant is fully insured and protected from all potential liability.

7 Subordination, Attornment & Tenant Security

Subordination & Attornment

- ▶ Standard commercial lease will require that tenant subordinate its lease and its rights thereunder to any landlord financing of the building or shopping centre and that the tenant agree to attorn to the holder of such financing.
- ▶ Subordination should be conditional on tenant being given a non-disturbance agreement.

7 Subordination, Attornment & Tenant Security (cont.)

Non-Disturbance Agreement

- ▶ Provides that if the tenant is not in default under its lease, and if the lender forecloses or takes possession of the building or shopping centre (or sells it to a third party), then tenant can continue to remain in possession of premises (will not be disturbed).
- ▶ Landlord should only agree to use commercially reasonable efforts to obtain an NDA.

7 Subordination, Attornment & Tenant Security (cont.)

Tenant Security

- ▶ Lease will prohibit tenant from (i) encumbering any property of tenant in the premises, without the landlord's prior written consent, and (ii) from charging the lease.
- ▶ Tenant should insist that language be inserted to permit it to do a financing.
 - At the very least, tenant should be able to encumber its goods, moveable trade fixtures, equipment and other personal property.

7 Subordination, Attornment & Tenant Security (cont.)

Tenant Security (cont.)

- ▶ If landlord permits tenant to encumber its personal property, should ensure proper protections are added to this section of lease:
 - Bona fide financing;
 - Landlord to approve loan documents;
 - Tenant not in default of loan; and
 - Lease or premises are not charged.

8 Assignment, Subletting & Change of Control

- ▶ **General Rule** - No assignment of lease or subletting of premises without prior written consent of landlord.

Assignment

- ▶ Tenant wishes to transfer the lease to a third party.
 - e.g. Tenant's business in the premises is not working out and tenant wishes to rid itself of its lease obligations.

Subletting

- ▶ Tenant wishes to grant a third party an interest in part or all of the premises.
 - e.g. Tenant leased 100,000 sq. ft. but only uses 75,000 sq. ft.
- ▶ Tenant becomes "sublandlord" of "subtenant".
- ▶ Sublet vs. License

8 Assignment, Subletting & Change of Control (cont.)

- ▶ Tenant should insist that Landlord's consent to assignment not be unreasonably withheld, conditioned or delayed.
- ▶ Tenant should also insist on inclusion of certain permitted transfers – should be addressed in offer to lease!

Permitted Transfers

- Affiliate / Related Corporation
- Sale of business
- Franchisee / Concessionaire
- Merger / Amalgamation
- Reorganization
- Tenant financing

8 Assignment, Subletting & Change of Control (cont.)

▶ Corporate Ownership

- Change of control of the tenant deemed to be a transfer under the lease (i.e. assignment) – will require landlord consent.
- Tenant should seek to delete this language or add necessary amendments.
- Should not apply to (i) public corporations whose shares are listed on recognized stock exchange, or (ii) if tenant undergoes an initial public offering.

▶ Disposition by Landlord

- Landlord should be free to sell the property and assign the lease.
- Tenant should insist that landlord remain liable for un-assumed obligations.

9 Default

Common Events of Default

- Non-Payment of Rent
- Failure to Observe Terms of Lease
- Writ of Execution
- Bankruptcy / Insolvency
- Non-Permitted Transfer
- Failure to Operate / Abandonment
- Tenant Fraud
- Tenant Security
- Winding Up / Dissolution of Tenant
- Receiver Appointed

▶ Cure Periods

- Lease should be amended to include cure periods for both monetary and non-monetary defaults.

9 Default (cont.)

Landlord Remedies

1 Preserve Lease

- Distress (Monetary Default)
- Relet Premises
- Action for Rent (Monetary Default) or Action for Damages
- Order for specific performance, injunctive relief or mandatory order (Non-Monetary Default)

2 Terminate Lease

- Right of Re-Entry & Forfeiture (BUT...beware of Section 19(2) of the *Commercial Tenancies Act* (Ontario) and similar provisions)

3 Other Remedies

- Guaranties / Indemnities
- Letters of Credit / Security Deposit / Other Security
- Sue original tenant (if lease was assigned)

10 Environmental

- ▶ Important for commercial leases for industrial premises, manufacturing facilities or similar uses.
- ▶ Compliance with environmental laws:
 - Landlord should ensure that tenant provides a covenant that it will comply with all applicable environmental laws.
 - Landlord should insist that tenant indemnify the landlord for any claims, losses, damages, penalties, fines, costs, fees or expenses resulting from hazardous substances caused by tenant.
- ▶ Limitation of tenant's liability
 - Tenant not responsible for pre-existing hazardous substances.

Other Important Lease Provisions

- ▶ Exclusive Use
- ▶ Co-Tenancy
- ▶ Indemnity / Guarantee
- ▶ Early Occupancy
- ▶ Nuisance
- ▶ Hours of Business
- ▶ Prohibited Uses
- ▶ Energy Conservation
- ▶ Telecommunications
- ▶ Restoration of Premises
- ▶ Alterations
- ▶ Heating, Ventilating and Air-Conditioning (HVAC)
- ▶ Liens
- ▶ Signage
- ▶ Surrender of Premises
- ▶ Holding Over
- ▶ Rules and Regulations
- ▶ Expropriation
- ▶ Damage and Destruction
- ▶ Landlord's Work / Tenant's Work

Questions?

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