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## COMMERCIAL LANDLORD AND TENANT AGREEMENTS: THE NEED FOR CAREFUL ANALYSIS

### Introduction: Meet Your New Old Tenant

Businesses in Alberta have experienced the impact of pipelines not being built, a precipitous drop in stock markets, a price war on oil that has sent prices plummeting, and a health crisis resulting in the closure of all “non-essential” businesses. The impact of all of this on business is not yet fully known. Enough is known to expect that it is, and will be, negative. Commercial tenants of all forms will be experiencing losses of income, cash flow shortfalls, and planning challenges. The duration is yet to be seen and whether businesses will survive is an unknown in many cases. A business that has its operations shut down will not likely last long. Shareholders will be tempted to take what they can and walk away. Creditors will be lining up.

One reality that has emerged is that business plans are changing. The business environment is fluid. A thoughtful and realistic business plan that was in place 6 weeks ago is ridiculous today. The plan that replaced it 4 weeks ago is likely stale. Any new plan is fraught with uncertainty about the future and will be revised often as new facts emerge and new risks are appreciated.

For commercial tenants, this bodes poorly. For commercial landlords, the tenant that you thought you had 6 weeks ago is likely nothing like the tenant you actually have today. Whatever business plan and model was being successfully employed by your tenant likely no longer applies.

### What Type of Tenant Do You Have?

In this ever-changing environment there will be 3 categories of commercial tenants: (1) those who pay without disruption, (2) those who seek a deferral or other accommodations, and (3) those who fail to pay. Category 1 is likely to be the exception for many landlords. Categories 2 and 3 are not the same thing – there is some overlap of considerations, but it is not total.

### The Law of Lease Contracts in Alberta

In Alberta, the lease contract, complemented by the common law, is the principal and presumptive law between a commercial landlord and tenant. Commercial leases differ from landlord to landlord, and

then from tenant to tenant with each landlord. Each lease must be considered based on its unique terms, and on the individual circumstances of the tenant. Managing a lease contract that is potentially at risk is not just a matter of having a single plan for all leases. Rather, the landlord will have strategic interests that guide behaviour in each circumstance. Exercising the remedies in the wrong order, prematurely, or too late, will have consequences.

### **What Are the Circumstances in This Case?**

In cases where a tenant seeks a deferral or other accommodations, or simply does not pay, there are some common questions that landlords will want to ask and some common issues to consider.

- How strong was this tenant's covenant, how strong is it now, and how strong will it be in the future? In 3 months? 6 months? A year?
- What are the landlord's and tenant's rights on default?
- Is there an applicable force majeure or other "exit" clause that needs to be considered and analyzed?
- Is there a personal property registry clause in or attached to the lease?
- Has the landlord registered its security? Can the landlord do so now?
- Are there guarantors who can keep the landlord whole for the unexpired term of the lease?

There are more questions about how secure the landlord actually is; which will drive the landlord's conduct in the face of a request for a deferral or an outright default.

### **Deferrals: Just a Lease Amendment Re-Negotiation**

In the case of a tenant asking for a deferral or other accommodations, the tenant is effectively asking the landlord for a loan. It happens to arise in the context of another relationship, but at its essence it is no different in principle than a tenant's incentive at the start of a lease. That, too, is really just a loan. The landlord would properly consider amortization terms and rates and would build that into the lease. Here, the tenant seeking a deferral or other relief is seeking a Lease amendment on a critical term - payment.

If the landlord says "no", will the tenant default? What are the landlord's and tenant's rights on default? Can the landlord expect the tenant to have a bank act as the tenant's bank? Has the tenant taken advantage of any of the emergency assistance plans released by various levels of government? Can the landlord negotiate personal property security, a guarantee from a parent company or a principal, or other consideration? It is not unreasonable for the landlord to consider what security or additional security is needed. Should the landlord ask to see the tenant's accounting records? A tenant who has cash and assets, and is planning for short- and mid-term cash flow challenges, might be a good investment. A tenant with a pre-existing poor balance sheet combined with a poor income statement would be looked at differently. That may result in a request of the latter tenant for "deeper" security to strengthen the covenant. If a tenant apparently in trouble can not get guarantors, that might be an important omen for the landlord. The landlord may be better to protect itself now with its termination rights and try to protect the unexpired term of the lease. Or should the landlord shore up security, in anticipation of an eventual breach of the lease by the tenant?

## **Defaults: A Loss Mitigation Exercise**

In the case of a defaulting tenant, again the landlord will want to look at whether it has security, whether it is filed, and whether it can file it at PPR now. The landlord will want to address that before issuing a termination notice, as a termination notice may end the landlord's right to register its security. Should the landlord exercise its security now?

The landlord will want to consider its rights. Does the landlord have to give notice and time to repair the breach, or can the landlord act now? A failure to abide by a notice clause, with a premature termination, may result in the landlord's loss of some or all of its rights in respect of the unexpired term of the lease. In fact, the landlord may have then breached the lease and the tenant may have remedies for damages against the landlord.

Typically, the landlord has a basket of cumulative rights. At common law, exercising any one of them may result in the loss of the other rights, unless done correctly. The seminal Supreme Court of Canada decision in *Highway Properties* (as interpreted by many Courts thereafter) provides a guide to landlords on how to terminate the Lease and to maintain, or lose, the other available remedies. Does the landlord want to now exercise an acceleration clause, and start proceedings against the tenant and any guarantors? Can guarantors be pursued at the same time as the tenant? Is this tenant likely to be able to pay, by way of judgment or voluntarily?

The order of exercising the cumulative remedies is also important. If the Landlord distrains assets, it may have brought the Lease current by taking assets in lieu of rent. Other cumulative remedies may be lost.

Similarly, the type of tenant and the premises are a variable. For example, a restaurant with paid for equipment, but no hope of survival, may be a more attractive space to re-let. That may be the best mitigation strategy in that case, but not in another case. A massage therapy business in a strip mall may offer fewer transition strategies.

## **Each Case is Different**

Given the myriad of possible circumstances, and the rapidly changing landscape, landlords will be well advised to carefully consider the law and facts in each case. A misstep could be the difference between total recovery and total loss.

The lawyers at JSS Barristers would be pleased to help navigate the complex issues arising in commercial leasing relationships.

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