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Shopping Center Legal Update

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In Depth

From Canada

Lease Assignment Limitations in Bankruptcy Expanded by Tower Records' Court Presents Mixed Bag for Landlords

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The assignability of commercial shopping center leases inside or outside of bankruptcy is typically viewed as primarily a two- or three-party negotiation or dispute—the landlord versus the tenant and the proposed assignee. A recent decision in the bankruptcy of the former Tower Records (Tower Records), *In re Three A's Holdings*, LLC, 364 B.R. 550 (Bankr. D. Del. 2007), however, went further, and conferred standing to challenge a proposed assignment on non-lease parties under certain use restrictions that were not a part of the lease.

During its bankruptcy case, Tower Records filed a request with the Bankruptcy Court to assume and assign one of its leases to Walgreens. A local municipality and the Downtown Owners' Association (the Owner's Association) in the area where the store in question was located, objected to Tower Records' request, asserting that allowing a Walgreens to operate in the former Tower Records' location would contravene certain use restrictions that were contained, not in the lease, but in certain downtown common interest development and use documents.

After some analysis, the Bankruptcy Court agreed with the municipality and the Owner's Association, and held that, despite the absence of objection by the landlord,[1] Tower Records would be prohibited from assigning the lease to Walgreens.

The scope of the Tower Records' decision and its potential impact on broader bankruptcy principles on standing and the assignability of leases under § 365 of the Bankruptcy Code may be cause for additional planning and considerations by both landlords and tenants (and their proposed assignees) in future cases.

The Facts, the Lease and the Use Restriction in Question

The relevant lease that Tower Records sought to assign to Walgreens did not contain any pertinent use restrictions, *per se*, that would have been violated by the proposed assignment. Rather, the lease stated that it was subject to certain use restrictions set forth in the Declaration of Covenants (the Downtown Covenants) for the Owner's Association where the store in question was located. The Downtown Covenants, in turn, provided that the permissible uses for businesses operating in the downtown area included "antique shops, bakeries, bookstores, florists, ***health supplies***, professional services, shoe repair and cinemas" (the Permissible Uses).

The municipality (City of Brea, CA) and the Owner's Association, in their objections, asserted that a substantial portion of Walgreens' pharmacy business did not fall within any of the Permissible Uses, including "health supplies."

The Bankruptcy Court's Decision

Restrictive Covenants

The Bankruptcy Court began its analysis by citing what it considered to be the applicable California state statute, Cal. Civ. Code §1468, which provided that restrictive covenants in deeds or other instruments conveying real property may run with the land to bind not only the original parties, but also their successors and assigns. The court then held that the Permissible Uses contained in the Downtown Covenants constituted covenants that run with the land. Accordingly, the court found that

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the assignment of the lease to Walgreens could be approved only if Walgreens' "proposed use and primary business complies with" one or more of the Permissible Uses.

Permissible Use

The court then analyzed whether Walgreens' business and proposed use were consistent with the "health supplies" Permissible Use set forth in the Downtown Covenants. The court held that Walgreens' business did not fit within the "health supplies" Permissible Use since Walgreens' primary business was "operating a retail pharmacy" and over 63 percent of Walgreens gross sales for all of its operations nationwide arise out of its sale of prescription drugs.

The court further held that, while it was not clear from the language in the Downtown Covenants whether the original intent of the parties was that "health supplies" would permit a business such as Walgreens, examination of a prior development agreement for the downtown area that originally expressly included "Drugstore" and "Pharmacy" as permitted uses demonstrated that the omission of "Drugstore" and "Pharmacy" from the Permissible Uses in the Downtown Covenants meant that those uses were not permissible.

In addition, the court found it significant that an attorney for the municipality (which objected to the assignment) testified that, in his view, the term "health supplies" did not contemplate the operation of a pharmacy.

Thus, the court reasoned that if the drafting parties had wanted to include "Pharmacy" as a Permitted Use, then "Pharmacy" would not have been omitted from the list of Permissible Uses contained in the Downtown Covenants.

Waiver

In response to Walgreens' assertion that the municipality and the Owner's Association had engaged in essentially "selective enforcement" of the Downtown Covenants by permitting other assignments to other businesses whose uses did not fall within the Permissible Uses, the court held that, while it appeared that there were some isolated cases where that had in fact occurred, the municipality and the Owner's Association would not be deemed to have waived the right to enforce the Downtown Covenants against Walgreens and Tower Records unless it was shown that the "general purpose of the plan was undermined" by the prior selective enforcement.

Assignment

Turning briefly to the right of, and the requirements for, a debtor in bankruptcy to assume and assign a shopping center lease under § 365 of the Bankruptcy Code, the court held that since the proposed assignment violated the land use restrictions contained in the Downtown Covenants, the court could not approve it.

Tower Records' Impact on the Standing of Objecting Parties

In bankruptcy cases, the general rule is that to have standing to object to a particular motion or request for relief, a party must be "aggrieved" such that the party's pecuniary interests are directly and adversely affected by the proposed relief. *In Re ANC Rental Corp.*, 57 Fed. Appx. 912 (3rd Cir. 2002). A corollary to this rule is that a general creditor of the debtor or a competitor of the debtor who is not a party to the underlying contract sought to be assumed and assigned does not have standing to object to the proposed assumption and assignment because any possible damages that may be sustained by such creditor or competitor are not sufficiently direct. *ANC*, at 914-916. *See, also, In re Farmland Industries Inc.*, 408 B.R. 497 (8th Cir. B.A.P. 2009) (unsuccessful bidder for debtor's assets was not an aggrieved party with standing to object to sale). The Tower Records' court, while acknowledging that (a) the landlord did not object to the assignment and (b) the objecting parties were not parties to the lease, nevertheless permitted their objections to carry the day.

It is also unclear why the Bankruptcy Court did not adopt the position that if the landlord improperly permitted its tenants to assign leases in violation of underlying use restrictions, then other state law remedies (including injunctive remedies) would be available to the objecting parties.

In addition, the basis is unclear for the Bankruptcy Court's "business as a whole" approach to evaluating whether Walgreens' nationwide business, versus its business at the specific store in question, fell within the Permissible Uses. Many retail chains operate actual pharmacies at select locations, perhaps at the bulk of their locations. But it is not clear why a bankruptcy court should predetermine which approach to use in a bankruptcy proceeding to assume and assign a lease under § 365. After all, a particular retail chain may choose not to operate a pharmacy at a given location, or may be subject to an injunction from doing so by a state court in an appropriate proceeding once it is found that a use restriction is being violated.

Supremacy Clause and § 365 of the Bankruptcy Code

A related issue that was not directly addressed by the court in Tower Records pertains to whether the proposed assignment under § 365 of the Bankruptcy Code could be circumvented by the use restrictions contained in the Downtown Covenants and the related California statute, which provides that such covenants run with the land, consistent with the Supremacy Clause of the U.S. Constitution and the doctrine of preemption.

It has been recognized in multiple contexts, including cases under §365 of the Bankruptcy Code, that state statutes and agreements which conflict with some provision or policy of the Bankruptcy Code contravene the Supremacy Clause and are

thus unenforceable. *See, e.g., In re Cardinal Industries, Inc.*, 105 B.R. 834 (Bankr. S.D. OH 1989) (general partner of an Ohio limited partnership could not have his management status stripped from him by virtue of the general partner's bankruptcy filings, even though Ohio's limited partnership statute and the partnership agreement contained provisions that would trigger such a result since, under the Supremacy Clause, any such state statutory and contract provisions conflicted with § 365 and were invalid).

Also see *In re Old Carco, LLC, f/k/a, Chrysler, LLC*, 406 B.R. 180 (Bankr. S.D. N.Y 2009). (State Dealer Day in Court Acts were preempted by § 365 of the Bankruptcy Code and, as a result, debtors would not be prohibited from rejecting automobile dealer franchise agreements, even though such rejections would conflict with State Dealer Day in Court statutes and/or dealer franchise agreements and rights.)

Rather than hold that the Downtown Covenants and the applicable state law were in conflict with and were preempted by the right of the debtor to assume and assign the lease under § 365, the court in Tower Records adopted the opposite approach, holding that the Downtown Covenants precluded an assignment of the lease otherwise authorized by § 365. That approach appears difficult to reconcile with the views expressed in *Cardinal Industries* and *Chrysler*.

Bankruptcy Code Policy Favoring Assignments

Section 365(f)(2) of the Bankruptcy Code expressly permits a debtor-tenant to assume and assign its lease if it can provide the landlord with "adequate assurances of future performance" of the lease by the assignee. Section 365(f)(1) goes further and provides that such an assignment is permissible notwithstanding any contrary provision in the lease "or applicable law" that prohibits, restricts or conditions such assignment. In enacting § 365 of the Bankruptcy Code, Congress expressed a policy favoring the assignment of leases in bankruptcy proceedings. *In the Matter of Federated Dept. Stores, Inc.*, 126 B.R. 516, 518 (Bankr. S.D. OH 1990).

In fact, in *In re Rickel Home Centers, Inc.*, 240 B.R. 826 (D. Del. 1998), the Delaware Bankruptcy Court was confronted with a shopping center landlord's objection to a proposed assignment by a debtor-tenant, based on certain use restrictions contained in the lease; and that court, contrary to the view of Tower Records, held that such use restrictions would be stricken as an unenforceable anti-assignment clause. Similarly, in *In re Tobago Bay Trading Co.*, 112 B.R. 463 (Bankr. N.D. GA. 1990), the court held that shopping center lease provisions that prohibit the debtor-tenant from conducting going-out-of-business sales would not be enforced by the bankruptcy court.

Conclusion

The decision in Tower Records is, no doubt, of much comfort to non-landlord/ non-tenant parties that may wish to block a lease assignment for a variety of reasons, none of which may involve preventing any actual prejudice or damage to those parties. In fact, it does not appear from the Tower Records' decision that any harm or damage was alleged by the municipality or Downtown Owner's Association, or would have been suffered by said parties if the assignment had been permitted.

The hurdles and impediments that a landlord and a tenant may need to overcome in a bankruptcy jurisdiction adopting the Tower Records line of authority will likely be more challenging. Even in a scenario where the tenant in bankruptcy is able to expressly demonstrate that the landlord and all other tenants of the shopping center favor the assignment to the new tenant, it appears, under the Tower Records' approach, that such an assignment can still be thwarted by third parties under certain circumstances. On the other hand, where a landlord seeks to oppose an assignment by its tenant in bankruptcy, Tower Records has likely given the landlord a more enhanced position to stand upon.

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[1]Although the landlord did initially object to the assignment on other grounds, it reached a resolution with Tower Records and Walgreens and withdrew its objection in the bankruptcy case.

Pursuing Fashion Fakes: A Review of Recent Fashion Counterfeiting Awards

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Deciding when to pursue fashion counterfeiters is a tough call. The vendors hawking fake Prada bags from a folding table may be judgment-proof. The websites peddling bogus Cartier watches often reside off-shore or are registered under false names. Is it worth it for fashion brands to go after these kinds of operations?

The *Lanham Act* provides attractive legal remedies. Willful counterfeiters are subject to mandatory financial penalties, and, absent unusual circumstances, the court *must* award treble damages or profits (whichever is greater) plus reasonable attorney fees if the counterfeiter knew the goods were counterfeit and intentionally offered them for sale.

In some cases, however, actual profits or damages may be difficult, if not impossible, to ascertain. Counterfeiters may maintain deceptive records or no records at all. In other cases, actual damages are so insignificant that they are unlikely to deter future counterfeiting. As an alternative, the *Lanham Act* permits so-called "statutory" damages: Rather than showing actual damages, a trademark owner can seek statutory damages ranging from $1,000 to $200,000 per counterfeit mark per type of goods and services, and up to $2 million if the infringement is deemed willful. Congress increased this range, previously set at $500 to $100,000 per mark ($1 million for willful infringement), in October 2008. Courts have wide discretion in these matters, and the amounts awarded are subject only to general principles of fairness. While the *Lanham Act* is silent on how this discretion should be exercised, courts nevertheless have held that the statutory award should have some relationship to the actual damages suffered and should be sufficient to deter the defendant without bestowing a windfall on the plaintiff. In the Southern District of New York, courts employ the analysis used in copyright cases, considering the defendant's expenses and profits, the plaintiff's lost revenues, the value of the trademark, the defendant's willfulness, the defendant's cooperation in providing information from which to assess the counterfeit goods' value, and the deterrent effect on both the defendant and others.

The recent decision in *Chanel, Inc. v. Banks,* Civil No. WDQ-09-843 (D.Md., Dec. 22, 2010), is instructive. The defendant in *Banks* was a young woman who allegedly operated a website through which she sold counterfeit Chanel handbags and wallets. Banks failed to appear or otherwise respond to the complaint, and Chanel moved for an entry of default judgment.

After determining that Chanel's allegations supported a finding of liability, the magistrate judge considered the appropriate amount of damages. Bereft of information about Banks's actual sales or profits, Chanel opted for statutory damages. The judge first determined that the "baseline figure" was within the range of $1,000 to $2 million. Chanel proposed trebling Banks's average gross sales based on inventory listed on the website. The court rejected this calculation as "speculative and imprecise" without information about Banks's sales. However, the court noted that gross sales may be an appropriate baseline figure where the absence of information was due to the counterfeiter's wrongdoing (such as improper recordkeeping) or if the ultimate award is discounted in some way to reflect profits more accurately, as awarded by a New Jersey district court in an earlier Chanel case.

Ultimately, the magistrate judge in *Banks* recommended a baseline figure of $2,000, multiplied by the number of marks (2) and trebled for willfulness, for a total of $83,000 in statutory damages. The judge emphasized the relatively insignificant size of the defendant's business: The inventory on the website in question amounted to between $6,000 and $7,000 in value, and the defendant's "operation was quite unsuccessful." For undisclosed reasons, the magistrate's final recommendation was for $126,000 in statutory damages plus attorney fees and costs, along with the issuance of a permanent injunction against, among other things, the future counterfeiting of Chanel goods.

Entertainment Law Matters, a Frankfurt Kurnit Klein & Selz's Litigation Group blog about disputes and developments in the film, television, publishing, theatre, music, art, gaming and fashion industries took a look at recent cases awarding damages for fashion counterfeiting. The editors found that, as a general rule, the size of the counterfeiting operation has a direct relationship with the amount of the award. Counterfeiting websites, in particular, sustain higher damage awards because of their far reach. Since the statutory damage range was increased in October 2008, courts have awarded damages ranging from $1,000 to $1 million per mark in fashion-brand counterfeiting cases.

In light of the potential recovery, fashion brands certainly have the financial incentive to pursue those who manufacture and distribute counterfeit goods. In addition to significant damage awards, fashion brands can recover attorney fees and costs, and courts will often order the destruction of the infringing goods. Moreover, the high monetary penalties may also serve to deter would-be counterfeiters. The challenge, of course, is collecting on these judgments. Statutory damages are provided, in part, because of uncooperative defendants who refuse to provide accurate information as to their sales figures and who, more often than not, simply do not appear to defend themselves in court. The likelihood of collecting from such defendants can sometimes be discouraging. Nevertheless, trademark owners who fail to prosecute may lose the strength of their marks or even be deemed to have abandoned them. This risk, along with the potential rewards, would seem to make such litigation a worthwhile endeavor in many cases.

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A Contract Reformed: A Cautionary Tale for the Transactional Lawyer

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The equitable remedy of reformation was the recent subject of a Missouri case: *Thirty and 141, L.P., et al. vs. Lowe's Home Centers, Inc.,* Case No. 4:06CV1781, SNLJ, United States District Court for the Eastern District of Missouri, Eastern Division, 2010 U.S. Dist. Lexis 88680. Reformation, in the context of contract law, is sought when the parties have entered into a binding agreement and some related writing does not conform to the agreement, due to either fraud or mistake. Naturally, the parties might agree that a mistake has been made and simply amend the agreement themselves; however, in those instances where the mistake is disputed or fraud is alleged, the party making the claim must meet the standard of clear and convincing evidence. The court may act only to impose upon the parties those obligations to which they agreed but did not adequately express in the document; it may not impose upon a party the terms of the "reformed" contract to which the party never agreed. *U.S. Legal.com.* In this sense, it is a difficult and rare remedy to obtain and requires the use of parol evidence to determine the true intent of the parties.

The case of *Thirty and 141, L.P., et al. vs. Lowe's Home Centers, Inc.* ("Thirty vs. Lowe's") involved property, in excess of two hundred (200) acres, located in Saint Louis County, MO. Thirty and 141, L.P., et al. and its related plaintiff entities ("Thirty") and Lowe's Home Centers, Inc. ("Lowe's"), began negotiating a lease for a home improvement store to be located on a portion of this property in 1998. Although the platting and subdivision of the 200 acres were not completed, Thirty's intent was to develop the overall property, or a portion thereof, into three (3) commercial areas referred to as the North shopping center, East shopping center and South shopping center, each of which abutted Highway 141 (the North and South shopping centers were to the west of Highway 141 and the East shopping center was to the east of Highway 141).

Lowe's proposed leased premises was located on the North shopping center. The lease, which was executed in 1999, included a negotiated use restriction to prevent another home improvement store within a certain geographic scope, as follows: "[Thirty] further agrees to immediately record a deed restriction on *each of the other proposed shopping centers abutting Highway 141* setting forth a "no home improvement store" restriction all as more specifically set forth on Exhibit E-2" (*emphasis added*). *Id.* at *3. Exhibit E-2 of the Lowe's lease contained a metes and bounds legal description of only the South shopping center, which consisted of 61 acres. By the time the required deed restriction, known as "Declaration 90," was filed in August 2000, the platting and subdivision of the 200 acres were completed. The North shopping center was reconstituted as Plat Three Lot 5, and the South shopping center was reconstituted as Plat Three Lot 6. The East shopping center became Plat Five Lots 1-9. Declaration 90, drafted by Lowe's, included legal descriptions of Plat Three Lot 6 (the South shopping center consisting of 61 acres) as well as Plat Three Lots 7 and 8 (consisting of 68 acres). While Lot 7 abutted the South shopping center and Lot 8 abutted the North shopping center, neither lot abutted Highway 141 nor were they part of the East shopping center.

Thirty filed its lawsuit seeking reformation of Declaration 90 in 2007, asserting a mutual mistake in that Lots 7 and 8 were not intended by the parties to be encumbered by the deed restriction. By this point, Thirty had an interest in leasing a portion of Lot 7 to Home Depot, a competitor of Lowe's in the home improvement business. Lowe's asserted no mistake and won a summary judgment motion. On appeal, the Eighth Circuit reversed and remanded based upon its determination that genuine issues of material fact exist by which one could find a mutual mistake with respect to the legal descriptions in Declaration 90 and that contained in the lease. *Thirty and 141, L.P., et al. vs. Lowe's Home Centers, Inc., 565 F.3d 443, 449 (U.S. App. 2009).* Where a disputed document contradicts a preexisting agreement, a mutual mistake can be inferred even where one party asserts that no mistake existed. *Thirty*, Lexis 88860 at *10.

Parol evidence became necessary in this case due to the apparent inconsistent language between the lease's use restriction provision, which referred to "other proposed shopping centers" in the plural form and the lease's Exhibit E-2 which only described one shopping center. The district court looked beyond the words of the contract to the details of the parties' negotiations and found that the parties only discussed the three proposed shopping centers abutting Highway 141 (i.e. the North, South and East shopping centers). There were no communications regarding additional property in the area, and grading and site plans were exchanged which depicted only the three proposed centers. The court concluded that any inconsistency as to Exhibit E-2 was explained by the facts. First, a legal description of the North shopping center was unnecessary on Exhibit E-2 because a site plan of the parcel was included as a separate exhibit. Second, the assemblage of the East shopping center by Thirty had not been completed at the time of lease execution; therefore, the parties orally agreed to include that description at a later date. (Indeed, Thirty recorded a separate deed restriction on the property consisting of the Plat Five East shopping center Lots 1-9.) Thus, only the South shopping center was included on Exhibit E-2 as a center abutting Highway 141.

In addition, the court reviewed correspondence between the parties during the lease negotiations regarding the scope of the use restriction whereby Thirty agreed to grant Lowe's an exclusive so that no other home improvement store would be located "in the Shopping Center or the retail portion of the landlord's development on the west side of Highway 141." *Id.* at *16. The court found that the parties had no discussions regarding retail development on the west side of Highway 141 other than what became the North and South shopping centers. Lots 7 and 8 were additional parcels to the west of Highway 141, but were not discussed by the parties as future retail developments.

The court concluded that the property comprising Lots 7 and 8 fell outside the boundaries of the three shopping centers that were the subject of all of the parties' communications and that they did not abut Highway 141; therefore, the parties did not intend to restrict the lots. Since Declaration 90 contradicted the preexisting lease agreement, a mutual mistake was inferred by the court. The court ordered that the use restrictions contained in Declaration 90 be conformed to the language of the lease and that any restrictions against Lots 7 and 8 be considered null and void.

This case presents a scenario that is common for transactional lawyers negotiating leases with an eye toward protecting an exclusive right. Leases and declarations are often not signed simultaneously for the very reasons cited in this case—i.e., property assemblages are not complete, subdivisions are delayed, etc. Certainly, one argument on Lowe's side is that while Lowe's was the drafter of Declaration 90, Thirty was the signatory and had the opportunity to review the terms and the attached descriptions before execution. It is noted in the case that several drafts of Declaration 90 were exchanged between the parties; however, the specific references in the Declaration indicating that it was made "pursuant to the terms of the Lease" and that Thirty was "required to record this Declaration" persuaded the court that there was a mistake in the Declaration 90 legal descriptions. The court may have reached a different result if the lease had contained broader language regarding the restriction to include the shopping centers, such as "and any enlargements thereof" or "the shopping centers and any additional property owned by Thirty" within a specific radius.

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Overview of the *Restore Online Shoppers' Confidence Act*

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Overview

In late 2010, the *Restore Online Shoppers' Confidence Act* ("ROSCA" or the "Act") passed in both chambers of Congress and was signed by the President.[1] ROSCA will become law once final administrative actions are complete.

The declaration of policy and legislative history indicate that the law was enacted primarily to protect consumers from "data passing"—i.e., consumers unknowingly authorize merchants to transfer their payment information to other merchants for a separate online sale, or sales, without otherwise requiring the consumer to reenter payment information. The legislative history focuses particularly on the post-transaction marketing of membership clubs, although the legislative history does not define the term "membership clubs."

The Act contains two primary prohibitions: (1) It prohibits and prevents Internet-based post-transaction third-party sales and (2) it imposes specific requirements on negative option features. The relevant terms and provisions are summarized in more detail below.

Definitions

For purposes of the Act, an "initial merchant" means "a person that has obtained a consumer's billing information directly from the consumer through an Internet transaction initiated by the consumer."

A "post-transaction third party seller" means a person that (1) sells, or offers for sale, any good or service on the Internet; (2) solicits the purchase of such goods or services through an initial merchant after the consumer has initiated a transaction with the initial merchant; and (3) is not the initial merchant or a subsidiary, affiliate or successor thereof.

Summary

Post-Transaction Third-Party Sales

ROSCA makes it unlawful for any post-transaction third-party seller to charge or attempt to charge a consumer's credit card, debit card, bank account or other financial account for any good or service sold over the Internet, unless the post-transaction third-party seller has clearly and conspicuously disclosed to the consumer all material terms of the transaction, including (1) a description of the goods or services being offered; (2) the fact that the post-transaction third- party is not affiliated with the initial merchant; and (3) the cost of the goods or services.

The post-transaction third-party seller also must have received the express informed consent for the charge from the consumer by (1) obtaining from the consumer the full account number to be charged and the consumer's name, address and contact information, and (2) requiring the consumer to perform an additional affirmative action, such as clicking on a confirmation button or checking a box indicating consent to the transaction.

Disclosure of Financial Account and Billing Information to Post-Transaction Third Parties

Under the Act, it is unlawful for an initial merchant to disclose a credit card, debit card, bank account or other financial account number, or to disclose other billing information used to charge a customer of the initial merchant to any post-transaction third-party seller for use in an Internet-based sale of any goods or services from that post-transaction third-party seller.

Negative Option Features

Finally, ROSCA prohibits any person from charging or attempting to charge any consumer for goods or services over the Internet through a negative option feature, unless the person (1) clearly and conspicuously discloses the material terms of the transaction before obtaining billing information; (2) obtains the consumer's express informed consent before charging the consumer; and (3) provides "simple mechanisms" for a consumer to stop recurring charges.

The term "negative option feature" is defined by the FTC's (Federal Trade Commission) Telemarketing Sales Rule as follows: "in an offer or agreement to sell or provide any goods or services, a provision under which the customer's silence or failure to take an affirmative action to reject goods or services or to cancel the agreement is interpreted by the seller as an acceptance of the offer." 68 Fed. Reg. 4670 (Jan. 29, 2003).

Although ROSCA does not provide any specific examples of "negative option features," in 2007 the FTC hosted a workshop that brought together industry representatives, consumer groups and members of the academic community to discuss negative option marketing. The report summarizing the workshop provided four examples of the types of marketing plans that fall into the negative option marketing category: (1) pre-notification negative option plans, (2) continuity plans, (3) automatic renewals, and (4) free-to-pay or nominal-fee-to-pay conversion offers.[2] In pre-notification negative option plans (e.g., book or music clubs), sellers send periodic notices offering goods to consumers. If a consumer takes no action, the seller sends the goods and charges the consumer. In continuity plans, consumers agree in advance to receive periodic shipments of

goods or provisions of services, which they continue to receive until they cancel the agreement. In automatic renewal plans, the seller (e.g., a magazine seller) automatically renews a consumer's subscription when it expires and charges for it, unless the consumer cancels the subscription. Finally, in a free-to-pay or nominal-fee-to-pay offer, consumers receive goods or services for free (or for a nominal fee) for a trial period. After the trial period, sellers automatically begin charging a fee (or higher fee) unless consumers affirmatively cancel or return the goods or services.

During the same FTC workshop, panelists discussed the "clear and conspicuous" disclosure requirements under the FTC's Telemarketing Sales Rule with respect to negative option marketing. Although this discussion did not relate specifically to ROSCA's disclosure requirements, given the FTC's enforcement authority under ROSCA, it may provide some guidance to sellers on how to comply with ROSCA's requirement that the material terms of any negative option transaction be "clearly and conspicuously" disclosed to consumers. The panelists recommended that marketers (1) place negative option disclosures in locations on their websites where they are likely to be seen, (2) label any disclosures (and any links to them) to indicate the importance and relevance of the information, and (3) use text for the disclosure that is easy to read on the screen (e.g., use fonts, colors and backgrounds that are easy to see and read, avoid long disclosures that require scrolling or clicking, and avoid the use of legal jargon).

ROSCA's restrictions on negative option features bear some similarities to restrictions on automatic renewal and continuous service offers in a California law that took effect on December 1, 2010. Although different from ROSCA, the California legislation imposes similarly rigorous information, notice and consent requirements on businesses that make automatic renewal or continuous service offers to California residents. Under the California law, offers of continuous services or automatic renewals (1) must present the offer terms in a "clear and conspicuous" manner, (2) must not charge the consumer's credit card without the affirmative consent of the consumer, and (3) may not change a material term of the offer without "clear and conspicuous" notice of the change. Finally, if the offeror sends goods, wares, merchandise or products to a consumer under an automatic renewal of a purchase or continuous service agreement without first obtaining the consumer's affirmative consent, the goods, wares, merchandise or products are deemed unconditional gifts to the consumer, and the offeror must bear their entire cost. ROSCA's restrictions on negative option features may portend a trend toward more federal regulation of the type of offering addressed by the California law.

Enforcement and Penalties

Violations of the Act are treated as violations of the FTC rules regarding unfair or deceptive acts or practices, and the FTC has the same powers of enforcement as those set forth in the *Federal Trade Commission Act*. Additionally, the attorney general of any state may bring an action on behalf of the residents of such state against any person violating the Act. Violators may be subject to the same penalties and are entitled to the privileges and immunities provided in the *Federal Trade Commission Act*.

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[1] Pub. L. No. 111-345, 124 Stat. 3618 (2010).

[2] Negative Options, A Report by the Staff of the FTC's Division of Enforcement, Federal Trade Commission (2009). http://www.ftc.gov/bcp/workshops/negativeoption/index.shtml (click on Text of the Staff Report).

Construction Contract Anti-Indemnity Statutes: Roadblocks to Risk Allocation

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The majority of U.S. states have now enacted statutes that invalidate construction contract provisions in which a party agrees to indemnify other parties for all liabilities arising from the negligence of the party being indemnified. Jeremiah M. Welch and Alexandrea L. Isaac, "How Anti-Indemnity Statutes Control Construction Contracts," *Conn. L. Trib.,* Nov. 2, 2009, at 17 (Vol. 35, No. 44); Allen Holt Gwyn and Paul E. Davis, "Fifty-State Survey of Anti-Indemnity Statutes and Related Case Law," *Construction Lawyer*, Summer 2003, at 26 (Vol. 23, No. 3). More states are targeted for this basic anti-indemnity legislation or for broadened anti-indemnity prohibitions that include restrictions on the insurance which a party can be required to maintain in a construction contract.

The Public Policy Reasons for Enacting These Statutes

The American Subcontractors Association (ASA) is an active proponent of these statutes. In the 2009 article, "Anti-Indemnity Statutes in the 50 States," the ASA provides a chart showing the status of all U.S. anti-indemnity laws (ASA Chart) and explains that provisions in which a subcontractor is required to indemnify the contractor and to insure for accidents that are not caused by the subcontractor "unfairly shift the financial responsibility for claims to the subcontractor." Foundation of the American Subcontractors Association, Inc., Anti-Indemnity Statutes in the 50 States" (2009):

http://keglerbrown.com/File%20Library/Practice%20Areas/Construction%20Law/2009-anti-indemnity-manual.pdf.

The public policy considerations against these construction contract provisions stem "from the notion that a general contractor, assured that it will be fully indemnified for its conduct (however reckless or dangerous) loses the financial incentive to exercise due care, and therefore sloughs off any moral responsibility to prevent foreseeable injury to others." Andrew A. Beerworth, "Emerging Trends in Construction Indemnity and Insurance Law," 58 *R.I. B.J.* 17, at 18 (2010).

This argument assumes (1) that ordinary negligence is something that parties can consciously prevent; (2) that liability and insurance for another party's ordinary negligence should not as a matter of public policy be allocated to a subcontractor; and (3) that a subcontractor is always in a weaker position and should be protected by law from the effects of its own contractual agreements.

However, the statutes that are being enacted across the country do not protect merely subcontractors or parties with inferior bargaining positions. With the exception of Chapter 149, § 29C, of the General Laws of Massachusetts and, to some extent, § 6-34-1 of the General Laws of Rhode Island, these statutes also protect contractors and, in most cases, owners as well. The law considers neither the bargaining position of the parties nor the facts or pricing of a particular construction project—the prohibitions are absolute. As a consequence, lawyers dealing with construction contracts must be mindful of the special rules that may nullify their negotiated risk-shifting provisions.

The Scope of Statutory Restrictions

To complicate the task of evaluating these risk-shifting prohibitions, the state statutes are by no means uniform; and, some of the state statutes are more rigid in their application than others.

Many state statutes invalidate only provisions requiring that a party to a construction contract pay for losses and damages arising from the other party's *sole negligence*. The statutes enacted in California, New Jersey, South Carolina and Virginia are examples of statutes in which only indemnification against the indemnitee's *sole negligence* is prohibited. Cal. Civ. Code § 2782; Ga. Code Ann. § 13-8-2; N.J. Stat. Ann. § 2A:40A-1; S.C. Code Ann. §32-2-10; Va. Code Ann. § 11-4.1.

In other states, the anti-indemnity statutes bar provisions that require a party to a construction contract to pay for the other party's negligence—whether the negligence is sole or contributory. The Oklahoma anti-indemnity statute specifies that the "indemnification shall not exceed any amounts that are greater than that represented by the degree or percentage of negligence or fault attributable to the indemnitor, its agents, representatives, subcontractors, or suppliers." Okla. Stat. tit. 15, § 221(C). Other states whose statutes invalidate provisions requiring an indemnitor to indemnify the indemnitee against its own partial negligence include Connecticut, Delaware, New York and Washington. Conn. Gen. Stat. § 52-572k; Del. Code Ann. tit. 6, § 2704; N.Y. Gen. Oblig. Law § 5-322.1; Wash. Rev. Code § 4.24.115.

In its 2010 regular session, Louisiana's legislature enacted Louisiana's first contractor anti-indemnity law, and it appears to provide the most protection for indemnitors in construction contracts. Section 9:2780.1(B) of the Louisiana Revised Statutes now renders unenforceable any provision contained in, collateral to or affecting a construction contract "which purports to indemnify, defend, or hold harmless, or has the effect of indemnifying, defending, or holding harmless, the indemnitee from or against any liability for loss or damage resulting from the negligence or intentional acts or omissions of the indemnitee, an

agent or employee of the indemnitee, or a third party over which the indemnitor has no control."

Even a party's agreement to provide indemnity for acts or negligence of "parties over whom the indemnitor has no control" is barred by this statute.

Most statutes provide that they do not affect the validity of insurance contracts. For example, the Delaware law specifies: "Nothing in subsection (a) of this section shall be construed to void or render unenforceable policies of insurance issued by duly authorized insurance companies and insuring against losses or damages from any causes whatsoever." Del. Code Ann. tit 6, § 2704; *see also, e.g.*, Conn. Gen. Stat. § 52-572k; Miss. Code Ann. §31-5-41; R.I. Gen. Laws §6-34-1. Virginia's statute states explicitly that it does not apply to "the validity of any insurance contract, workers' compensation, or any agreement issued by an admitted insurer." Va. Code Ann. § 11-4.1.

Other states not only invalidate a party's obligation to indemnify another party for its own negligence, but also void a party's obligation to maintain insurance that would cover the other party's negligence or, in some cases, any negligence other than the negligence of the party required to provide the insurance. Okla. Stat. tit. 15, § 221(C). Oklahoma's statute, which is cited above, also protects the indemnitor's insurer from providing coverage in excess of the degree or the percentage of negligence or fault attributable to the party providing the insurance. Similarly, Louisiana's new statute states that a contract requiring a party to a construction contract to "procure liability insurance covering the acts or omissions or both of the indemnitee, its employees or agents, or the acts or omissions of a third party over whom the indemnitor has no control is null void and unenforceable." La. Rev. Stat. Ann. § 9:2780.1(C).

The Policy and Drafting Concerns

Certainly, public policy should encourage contracting parties to act responsibly and protect the safety of workers and visitors. In *Pierre Condominium Association v. Lincoln Park West Associates, LLC*, 881 N.E.2d 588, 593 (Ill. App. Ct. 2007), the court explained that "The Indemnification Act was enacted to thwart the common construction industry practice of using indemnity agreements to avoid liability for negligence and to ensure a continuing incentive for individuals responsible for construction activities to protect workers and others from injury."

However, many, if not most, of the current anti-indemnity statutes are broader than is necessary to accomplish this public policy goal. They certainly protect a small contractor or a subcontractor performing a discrete construction task from an obligation to indemnify the owner or primary contractor for accidents not caused by the small contractor or subcontractor. However, many, if not most, of the current anti-indemnity statutes also protect large construction contractors in situations in which unfairness may result from the statute's application.

In many large construction projects, the entire construction site is turned over to the primary contractor and, as part of the contract price, the primary contractor assumes responsibility for and agrees to maintain the liability insurance covering all accidents that occur in connection with the construction or with respect to the property while the work is being performed, without consideration of the cause of the accident. Parties adopt this approach to reduce construction costs and make one liability insurer obligated to defend and pay all claims, without litigation among a number of insurance providers.

However, the broad anti-indemnity statutes will nullify agreements that seek to implement this approach. Worse, an unrepresented owner using a national form contract that imposes total liability for the job site on the contractor may not know that its contractual risk allocations are void. In this situation, the owner may rely on the contractor's unenforceable written obligations and may not procure the insurance it needs to cover its own negligence.

What Can a Lawyer Do?

It is important that a lawyer representing a client on construction matters review the statutes of each state in which its client is operating, whether as the owner or contractor, to see if that state has adopted a construction anti-indemnity statute. If that state voids certain indemnities or insurance requirements in construction contracts, then the lawyer should include contractual provisions that conform to the statutory restrictions; the lawyer also must urge the client to maintain its own insurance to cover the liabilities that cannot be assumed by the other party.

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A Lease Should Say What You Mean!

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Poorly drafted leases affect everyone, from individual residents, restaurant owners, business owners, property owners and, yes, even tenants who are attorneys … especially, attorneys who represent themselves in negotiating their leases. Well-crafted leases are lengthy and contain provisions to address every hypothetical scenario the drafter can drum up. Unfortunately, many parties to a lease do not even read them until a dispute arises. All of a sudden, the lease, as with a mystery novel, becomes a real page-turner, with everyone reading it cover to cover, trying to interpret the language most favorable to his or her cause.

The three most important criteria in judging the adequacy of a commercial lease are *language*, *language* and *language*. In a recent case, the Maryland Court of Special Appeals determined that a "certified public accountant" need not be independent unless the word "independent" is used as a modifier in the lease, and that the word "final" really does mean final. The court also determined that a requirement in a lease regarding one party's performance is not necessarily a condition precedent to the other party's performance … unless magical words such as "if," "provided that," "when" or "after" are used in describing the conditional relationship between specific obligations of the parties.

When it comes to interpretation, the courts will look first at the language of the lease. The general rule of thumb is that if the language is not ambiguous or vague, then what the lease says, goes. A recent case involving a well-known Baltimore-based law firm, Gebhardt & Smith, LLP ("G&S") illustrated this lesson, when the Court of Special Appeals upheld a Baltimore City Circuit Court award to G&S's landlord to the tune of just over $328,000.[1] This general rule provides consistency, and gives the parties to a lease the ability to determine their own fate. While there are always exceptions, most of the time, a lease clearly expresses the intent of the parties, and the courts will uphold the provisions if a dispute arises. However, when read by a judge, the lease may seem clear and unambiguous, but may not express with precision what one of the parties thought was meant by certain language used in the lease.

For nearly 30 years, G&S leased office space in the Baltimore World Trade Center, which was operated by the Maryland Port Administration ("MPA"). As with most commercial leases, the tenant not only paid base monthly rent, but also was responsible for its proportional share of additional charges, including real estate taxes and "operating expenses," which were similar to a net lease in a shopping center. The lease was amended several times throughout the years; however, the core issues addressed by the Court of Special Appeals in its 2009 decision involved obligations set forth in the original lease.

In 2003, Hurricane Isabel wreaked havoc over Baltimore, and the World Trade Center in Baltimore's Inner Harbor was amongst its casualties. The basement equipment rooms were flooded; as a result, the building was closed for approximately two months. During its displacement, G&S received an invoice from the MPA for actual operating expenses for the 2002 fiscal year, as well as the estimated operating expenses for fiscal year 2004. G&S became concerned that some of the charges may not be authorized operating expenses chargeable to the tenants under the lease. Reports were produced by an accounting firm, Ernst & Young, LLP, for G&S's review. However, G&S argued that the reports were insufficient and clearly were not a standard audit opinion because Ernst & Young simply reviewed the financial statements produced by the Maryland Department of Transportation ("MDOT") and did not conduct an additional investigation into those statements to determine whether the charges in the statements were authorized charges to the tenants under the terms of the lease. G&S claimed that Ernst & Young should not be relying so completely upon an *internal* audit prepared by a CPA employee of the MDOT. When G&S refused to tender payment of the operating expenses, a lawsuit followed.

G&S contested the interpretation and application of two provisions in its lease with the MPA. First, it argued that the MPA failed to satisfy a *condition precedent* of the lease, which required an "independent" certified public accountant to determine the amount of operating expenses. Second, it argued that the findings of the certified public accountant could be contested, notwithstanding the language contained in the lease providing that the landlord's accountant's determination of operating expenses would be "final." The court of appeals did not agree with either of G&S's contentions.

Condition Precedent

The lease contained the following language regarding the determination of operating expenses:

> The statements of the real estate taxes and operating expenses to be furnished by Lessor as provided in subdivisions (b) [real estate taxes] and (c) [operating expenses] above shall be as determined by Lessor's certified public accountant. *Gebhardt*, 982 A.2d 880

G&S contended that the lease should be interpreted to mean that an *independent* certified public accountant must determine the proper operating expenses charged to the tenants. Additionally, G&S proffered that because the MPA failed to

engage an *independent* certified public accountant to determine the amount of the operating expenses charged to the tenants, MPA failed to satisfy a condition precedent to G&S's obligations to pay the operating expenses; therefore, such amount was not due. The court rejected this argument.

The court further noted that the lease did not contain the standard language or key words associated with a condition precedent such as "if," "provided that," "conditioned upon," "subject to," "when" or "after." A condition precedent can have severe implications; therefore, courts are generally not quick to declare the existence of a condition precedent without a clear indication that was the intention of the parties to the contract. *See Gebhardt* at 896. As a result, the court found that there was no condition precedent to G&S's obligations to pay the operating expense. *Gebhardt* at 897.

In addition, G&S argued that the intention of the parties required an independent audit. The court found that the language of the lease was not ambiguous or vague. The lease merely required that the operating expenses be determined by the "Lessor's certified public accountant." The term *independent* is not used, nor is there any indication that an *independent* certified public accountant was required. Because no independent certified public accountant was required, there was no condition precedent.

It can easily be reasoned that G&S may have intended that an independent third party establish the operating expenses to avoid allegations of fraud; however, it can just as easily be noted that such independence is not required because the specific language was not included in the lease. The argument can be made that the language is vague because it does not define what is meant by "Lessor's certified public accountant"; but, absent any definition, the proper interpretation is that the Lessor can choose whomever it wants to make the required determination, as long as that person is properly licensed as a CPA.

Final Determination

The lease also contained the following language regarding G&S's ability to contest the findings of the certified public accountant:

> The statements thus furnished to the Lessee shall constitute a final determination as between Lessor and Lessee of the real estate taxes and operating expenses for the periods represented thereby. *Gebhardt*, 982 A.2d 880

G&S argued that the "final" determination could be contested because the lease did not contain a provision preventing such action. Unfortunately for G&S, final determination clauses are strictly enforced. The court held that "when a contract designates a third party, or one of the parties, to make a binding decision, that decision is subject to judicial review only in limited circumstances." *Gebhardt* at 901. The court found that the language of the lease clearly set forth the intentions of the parties that the determinations made by the landlord's certified public accountant were final and conclusive. *Gebhardt* at 902. When a contract provides that a determination rendered by a designated person is "final," that determination is binding on the parties and cannot be contested in court in the absence of fraud or bad faith. *Gebhardt* at 903.

While such a provision may favor one party, the purpose of such a provision is to avoid potential litigation. In this particular case, it is likely that G&S made this particular argument only in conjunction with its argument that an independent certified public accountant was required. If a true, independent, third party determined that the operating expenses sought by the MPA, then there may not be a need to raise this argument. It appeared from the facts of the case that G&S believed that an internal audit could not truly be impartial, and, therefore, wished to contest the findings of the certified public accountant, as those findings were based upon information provided from the internal audit. The court, however, found no acts of fraud or bad faith, and therefore held the provision to be binding on the parties.

Conclusion

The lesson to be learned is that if the parties to a contract *intend* a particular obligation, duty or course of action, or if there is a common understanding between the parties, that intention or understanding should be set forth in the lease with precision and clarity. It is well known that the contract is the first place a court will look to determine the intentions of the parties; therefore, if an intention is not clearly set forth within the document, the courts will have little else to rely upon in making its determination. A court will take the position that the written lease contains all of the parties' objectives and intentions. In the absence of ambiguity in the language of the lease, regard will not be afforded to what one party thought the lease meant.

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[1] *Gebhardt & Smith, LLP v. Maryland Port Administration*, 982 A.2d 876, 2009 Md. App. LEXIS 172 (2009).

When All Appropriate Inquiry Isn't Enough: Court Highlights the Significance of Other Factors in the *Bona Fide* Prospective Purchaser Defense

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Anyone who has been involved in a real estate transaction relating to commercial or industrial property has likely dealt with conducting "All Appropriate Inquiry" into the site, which generally includes the preparation of a Phase I Environmental Site Assessment and may include Phase II sampling work. All Appropriate Inquiry ("AAI") is one necessary component of the "bona fide prospective purchaser" ("BFPP") defense established under the 2002 Brownfields amendments to the *Comprehensive Environmental Response, Compensation and Liability Act* ("CERCLA"). The BFPP defense is intended to protect property owners from liability for contamination that clearly occurred prior to their period of ownership. However, conducting AAI is not the only prerequisite to establishing a BFPP defense. The BFPP requirements beyond the AAI are highlighted in *Ashley II of Charleston, LLC v. PCS Nitrogen, et al.*, 2010 U.S. Dist. LEXIS 104772 (D.S.C. Sept. 30, 2010), which is one of the first cases to address, in detail, the BFPP defense.

In this case, Ashley purchased property that had a long history of industrial use. In conjunction with that purchase, Ashley's environmental consultant performed Phase I and Phase II work. After the purchase, Ashley demolished many of the above-ground improvements on the property. When liability for contamination at the property was addressed, a significant battle arose between several potentially responsible parties. Ashley sought to take advantage of the BFPP defense to avoid liability. The elements of the BFPP defense are, in summary:

a) Disposal of hazardous substance occurred prior to acquisition;

b) The purchaser conducted an AAI;

c) The purchaser provided all required notices with respect to the discovery or release of any hazardous substance;

d) The purchaser exercises appropriate care with respect to hazardous substances found;

e) The purchaser cooperates with agencies;

f) The purchaser complies with institutional controls;

g) The purchaser complies with information requests or administrative subpoena;

h) The purchaser is not affiliated with a potentially responsible party.

In the end, the court closely scrutinized each element of the test and determined that Ashley was not a BFPP.

All Appropriate Inquiry

Significantly, this is one of the first cases to address the proper conduct of an AAI. The court found that although there were "inconsistencies" between the Phase I reports and the relevant ASTM (American Society for Testing and Materials) standard, those inconsistencies lacked significance. The court stated that "[w]hat is important is that Ashley acted reasonably; it hired an expert to conduct the AAI and relied on that expert to perform its job properly." Because the court did not explain what the "inconsistencies" are, it is difficult to determine how strictly a Phase I must comply with the ASTM. Interestingly, no federal agencies were involved in this case. The EPA has stated that it will insist on very strict compliance with the ASTM standards to find that an AAI was conducted. This case may (or may not) take some wind out of that sail. While strict compliance with the ASTM standards is still highly recommended, this case provides some potential relief for past transactions where the acquiring party is trying to mount a BFPP defense; however, the adequacy of its AAI is called into question due to the absence of strict compliance with the ASTM.

Appropriate Care

The court did find that Ashley failed to prove that it exercised appropriate care with respect to known contamination when it did its demolition work. In doing this work, Ashley did not clean out and fill in known underground sumps and concrete pads, which failure could have exacerbated known releases and contamination. Ashley also failed to prevent debris piles from accumulating, and failed to investigate and remove the debris piles on a timely basis. In addition, Ashley failed to maintain run-off controls.

This finding highlights the need for post-closing attention to known environmental issues. The BFPP defense requires that a purchaser stop continuing releases; prevent threatened future releases; and prevent or limit human, environmental and

natural resource exposure to previous releases. Prior to demolition, Ashley knew that the underground sumps contained hazardous substances, were cracked and were often filled with rainwater. Ashley never conducted testing during its period of ownership to determine if the soil below the underground structures was contaminated. Accordingly, Ashley "did not prove that no disposals occurred on the Site after its acquisition of the Site." Note the burden imposed by the court to prove a negative. The primary issue, however, appears to be that Ashley did not make even a limited effort with respect to the underground structures.

No Affiliation With a Potentially Responsible Party (PRP)

This final issue is important for contract drafting and negotiation purposes. Here, the court found that Ashley *was* affiliated with a PRP because, when Ashley purchased the property, Ashley agreed to indemnify prior owners from all environmental liability at the site, even if such liability was the result of a release that occurred prior to Ashley's ownership. There was no apparent relationship between Ashley and the indemnitees, other than this indemnity provision of the purchase agreement. Ashley then attempted to persuade the EPA not to name the indemnitees as PRPs, even though they were prior owners and operators during the time of releases. The court found that Ashley and the indemnitees were "affiliated" by operation of the indemnity, and that Ashley's conduct "reveal[ed] just the sort of affiliation Congress intended to discourage."

There may be some serious question regarding the court's interpretation of congressional intent. Nevertheless, this holding suggests that those negotiating the acquisition of property need to be concerned that, according to the *Ashley* court, a purchaser's indemnity of the seller for pre-closing releases to the environment could eliminate the ability of the purchaser to later mount a BFPP defense.

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Update to Federal District Court Case Involving Classification of Franchisees as Employees

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New developments in the case *Awuah, et al. v. Coverall North America, Inc.*, Civil Action No. 07-10287-WGY, in the United States District Court for the District of Massachusetts, are worth noting. To recap, in March 2010, the court found that under state law, Coverall's Massachusetts franchisees had been misclassified as independent contractors and should instead have been treated as employees. At the beginning of the trial, the plaintiffs failed to present sufficient evidence of damages for the misclassification claim, so the court dismissed that claim. On May 26, 2010, the jury returned a verdict in favor of Coverall on the remaining claims. The court subsequently permitted the plaintiffs to file an amended complaint on the misclassification issue, however, naming new class members, including one who was named Graffeo. The court denied the plaintiff's motion for class certification, without prejudice to the possible certification of a class in the future. All but one of the named plaintiffs then agreed to arbitrate their claims, leaving Graffeo as the sole remaining plaintiff. The other plaintiffs received little or no compensation in the arbitration proceeding, depending on their individual circumstances.

On Sept. 28, 2010, the court called into question Coverall's practice of withholding payments to Graffeo until Coverall had itself collected payment from clients served by Graffeo's franchised business as possibly violating the timing requirements under the *Massachusetts Wage Act*. The court was unable to determine whether Graffeo had suffered damages under the *Massachusetts Wage Act*, however. As a result, on Oct. 26, 2010, the court certified four questions to the Massachusetts Supreme Judicial Court, all of which relate to the *Wage Act*. As of the date of this writing, the Massachusetts Supreme Judicial Court has not ruled on the questions. The outcome of Graffeo's case is significant because if the court finds that Graffeo suffered damages as a result of his misclassification, Graffeo may be able to move to certify a class of Massachusetts franchisees who suffered the same damages. If, however, the questions are answered in such a way that results in Graffeo being found not to have suffered damages under the *Wage Act*, the case will be terminated.

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It Ain't Easy Being Green

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Perhaps proving the adage that no good deed goes unpunished, the U.S. Green Building Council ("USGBC") is the target of a lawsuit alleging that the USGBC has violated federal law and New York State law, based on false advertising regarding the LEED certification system. The lawsuit, entitled *Henry Gifford, et al. v. U.S. Green Building Council*, Case No. 10-cv-7747 LBS, is pending in federal court in the Southern District of New York. Originally, the plaintiffs sought class-action status; the original complaint also sought relief under federal antitrust laws. Based on an amended complaint filed in early February 2011, the plaintiffs—now limited to an engineer, a company that provides heating and cooling systems, an architect, and several consultants—seek relief under the *Lanham Act* and several New York State statutes.

The thrust of the complaint is that the USGBC has misrepresented the scientific basis for the LEED certification system as well as the significance of those persons who have LEED accreditation. The plaintiffs claim that they have been damaged by the predominant market position of the USGBC's LEED rating system, which displaces those professionals who are more qualified and experienced in designing energy-efficient buildings, but who are not LEED- certified.

One of the significant allegations in the lawsuit is that the LEED rating system is not based on objective, scientific criteria. Specifically, the plaintiffs assert that the LEED system is not based on actual measurements of building performance, but instead on computer modeling of anticipated energy usage for a given building. The plaintiffs also claim that the USGBC commissioned a study by the New Buildings Institute ("NBI"), which resulted in misleading results—at least as the USGBC has characterized those results. The plaintiffs alleged that the USGBC has misrepresented the following information from the NBI study:

- The new buildings certified under the LEED certification system are, on average, performing 25%–30% better than non-LEED certified buildings in terms of energy use.
- LEED buildings are 25%–30% more energy-efficient than non-LEED buildings.

The plaintiffs claim this information is misleading for the following reasons:

- The NBI study sample was comprised of just 22% of LEED-certified buildings, not all LEED-certified buildings.
- A little less than half of the respondents to the study submitted data that NBI deemed actually sufficient to include in the study.
- Less than half of LEED-certified buildings responded to the survey, and half of them were eliminated from the sample.
- The fact that owners of LEED-certified buildings have a vested interest in boosting the value of LEED certification, thus presenting a bias in the results of the study.
- The NBI study compared a set of new buildings to a sample of both new and old buildings.
- The NBI study compared buildings from a database of more than 5,000 buildings—some of which were built as early as 1920—to a LEED sample consisting of buildings built or renovated after 2000. The buildings constructed post-2000 may reflect better energy usage based on widely used building practices and materials, and not necessarily attributable to LEED elements.
- The NBI study compared the median energy use of LEED buildings to the mean energy use of the buildings from the larger sample.
- There is a difference in calculation between the larger sample on mean average energy and the LEED records on median average.

Plaintiffs also take aim at the LEED certification process. According to the plaintiffs, the USGBC claims that the LEED system provides third-party verification that a building was designed and built using strategies to improve performance across all metrics that matter most—i.e., energy savings. The plaintiffs claim that this assertion is false because LEED certification does not require verification that the data submitted for certification actually include any energy use data, that LEED certification is not based on actual building performance, and that the USGBC does not have staff or expertise to even evaluate applications for LEED certification.

The plaintiffs seek an injunction to prevent the USGBC from advertising the LEED certification based on the alleged false claims: (1) to require the USGBC to issue corrective advertising and (2) to compel the USGBC to disclose actual energy use of LEED properties. The plaintiffs also seek damages, including any USGBC profits deriving from unlawful conduct.

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Cases

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LANDLORD/ TENANT

A U.S. bankruptcy court in South Carolina finds that an amended lease that was executed by the tenant as an accommodation to the landlord in order to allow the landlord to obtain a loan that (i) did not lack consideration, (ii) was valid and (iii) was not executed under duress. *In re Sea Turtle Cinemas, Inc.*, 440 B.R. 438 (Bankr.D.S.C. Dec. 9, 2010).

On Nov, 15, 2005, Sea Turtle Cinemas, Inc. ("the Tenant"), entered into a lease (the "Original Lease") with Sea Turtle Entertainment, LLC ("the Landlord"), for the operation of a 45,000 sq. ft., 12-screen movie theater in the Berkeley Place shopping center in Bluffton, SC. The landlord and the tenant are owned by the same group of individuals and entities.

In March 2007, the Landlord applied for a $23,500,000 loan ("the Loan") with CIBC World Markets Corporation ("CIBC") to be secured by the shopping center, including the space leased by the Tenant. Just prior to closing the Loan, the principal of both the Landlord and the Tenant was notified that, for the Loan to close, an increase in rent for the Tenant's theater was required. As a result, on June 29, 2007, the principal executed an amended lease ("Amended Lease") on behalf of both the Landlord and the Tenant, increasing the rent from $55,000 per month under the Original Lease to $66,000 per month under the Amended Lease.

1. ***Consideration.*** The Tenant argued that the Amended Lease was invalid due to a lack of consideration in connection with the execution of the Amended Lease. The bankruptcy court held that the Tenant incurred a detriment from the execution of the Amended Lease and that, in exchange, the Landlord incurred benefits both from CIBC and the Tenant. The bankruptcy court stated that "[i]t is immaterial that Tenant did not receive a direct benefit from its execution of the Amended Lease. Especially in cases where entities are closely related, as in the present case, consideration generally exists for the extension of a loan to one of the parties because both related entities are actually benefiting from the transaction."
2. ***Duress.*** The Tenant also argued that the Amended Lease was invalid because it was executed under duress. The bankruptcy court held that the Tenant's representative (i) had the benefit of counsel during the course of the Amended Lease transaction and in connection with the CIBC Loan closing, and (ii) was a sophisticated businessperson who was engaged in numerous business dealings over the course of several years. Additionally, the bankruptcy court stated that the "mere fact that Landlord was facing an imminent financial crisis does not justify a finding that the Amended Lease was executed" by the Tenant under duress.
3. ***Ruling.*** The bankruptcy court found that the Amended Lease is effective and controlling. As a result, rent should be paid at the amount specified in the Amended Lease, and any accrued and owing rent under the Amended Lease should be paid.

LEASES/ CONTRACT INTERPRETATION

The Minnesota Court of Appeals finds that, where the district court's interpretation of the contract is supported by plain and unambiguous language of the contract itself, extrinsic evidence need not be considered. *C.W. Birch Run, LLC v. Jo-Ann Stores, Inc.*, 2010 WL 5071394 (Minn. Ct.App., Dec. 14, 2010).

Jo-Ann Stores, Inc. ("the Appellant"), operated a store in Maplewood, MN, in the Birch Run Shopping Center ("Shopping Center"). The Appellant entered into a 10-year lease for the premises in 2000 ("Lease"). C.W. Birch Run, L.L.C. ("the Respondent"), purchased the Shopping Center in 2004, assuming all rights and responsibilities of its predecessor under the lease.

The Respondent's predecessor owned most, but not all, of the Shopping Center. When the Appellant signed the Lease, the Respondent's predecessor did not own the "Toys R Us" parcel, which was owned by Toys R Us, Inc ("Toys R Us").

Under one section of the Lease, the Respondent's predecessor, as landlord of the Shopping Center, agreed that it would not lease to a second-hand or used goods store. The Respondent's predecessor also had a Reciprocal Easement Agreement with Toys R Us, executed in 1991, and which precluded either party from leasing space to a second-hand or used goods store (the "REA").

In August 2004, the Respondent acquired both the Shopping Center and the Toys R Us parcel. By doing so, the Respondent became the only party to the REA. On Dec. 9, 2005, the Respondent amended the REA by eliminating the prohibition against leasing to a second-hand or used goods store. On Dec. 9, 2005, the Respondent leased the Toys R Us parcel to T.V.I., Inc., for a "Savers Store," which sells second-hand and used goods. In November 2009, the Appellant sued the Respondent for a violation of the Lease terms and indicated that it would exercise its option under the Lease to pay reduced rent—although the Appellant subsequently backed away from this position.

The district court concluded that "[t]he language of [the section prohibiting certain uses] is plain and unambiguous and prohibited certain uses at sites in the Shopping Center, which does not include the Toys Parcel." The district court further concluded that the parties to the Lease were "sophisticated commercial entities who the court can reasonably assume understood and accepted the plain and unambiguous language of the Lease. This would include an understanding that [this section] of the Lease prohibited certain uses only within the Shopping Center and would not extend to stores located on the Toys Parcel."

Notwithstanding the Appellant's argument that the district court interpreted the term "Shopping Center" too narrowly, the court of appeals found that (i) the legal description of the Shopping Center was full, complete and accurate; (ii) simply because the Shopping Center "looked" like a unified site (with unified signage), the appearance of the Shopping Center alone cannot alter the unambiguous terms of the contract; and (iii) a court will not consider extrinsic evidence unless a contract is ambiguous on its face.

SIGNAGE/ RESTRICTIVE COVENANTS

The Eleventh U.S. Circuit Court of Appeals affirms the lower court ruling, which held that both the covenantee and the advertiser had breached neither their contracts nor their duties of good faith and fair dealing with the covenantor; nor did they conspire to deny the covenantor the opportunity to install a billboard on its property. *The Michael Titze Company Inc. v. Simon Property Group, Inc. and The Lamar Companies,* 2010 WL 3995938 (11th Circuit; Oct. 13, 2010).

In 1970, James Reeves purchased an outlot of a shopping mall from Pensacola Associates. Reeves and Pensacola Associates executed an operating agreement, which contained restrictive covenants to run with the land and bind the parties and their successors for 50 years. In 1984, The Michael Titze Company ("Titze") purchased a leasehold interest in a restaurant on the Reeves property. In 1986, Titze opened a different restaurant on the property and later exercised an option to purchase the property.

Notwithstanding their prior recording, Titze was somehow unaware of the existence of restrictive covenants affecting the property. The restrictive covenants required Titze to obtain permission from Simon Property Group, the owner of the adjacent mall ("Simon"), to construct on or to improve the property and not to use the property in a manner that would conflict with the interests of or detract from the shopping mall. The key restrictive covenant reads as follows:

> Prior to commencing any construction or improvements on Parcel D, [the purchaser] agrees to cause all grade, elevation, site and building plans, relating to the development and improvement of said Parcel D to be submitted to [the other of the mall], for…approval [by the owner], to the end that Parcel D will be compatibly developed and improved with the balance of the Total Shopping Center Site.

In 2003, Titze leased a portion of its property to The Lamar Companies ("Lamar") to install a billboard without obtaining approval from Simon. The lease allowed Lamar "to make necessary applications with, and obtain permits from, governmental bodies for the construction and maintenance of [Lamar's] advertising structure(s), at the sole discretion of [Lamar]" and provided that "[a]ll such permits [remained] the property of [Lamar]." Lamar obtained a permit to build the billboard, but Titze delayed that construction to renovate its restaurant. Before construction of the billboard commenced, Lamar contacted Simon to seek approval for the removal of a tree that was in the way of the location of the billboard. Thereafter, Simon notified Lamar that the operating agreement precluded the billboard. And, following Simon's refusal to allow the billboard, Simon and Lamar entered into an agreement whereby Simon contracted with Lamar for construction of the billboard on other Simon property.

1. ***Breach of Operating Agreement.*** Titze argued that Simon breached the operating agreement by withholding unreasonably its approval to install a billboard on Titze's property. Under Florida law, "the standard to be applied to determine whether consent was unreasonably withheld is that of the reasonably prudent man and that consent is not to be arbitrarily withheld." *Sun First Nat'l Bank of Orlando v. Grinnell,* 416 So.2d 829, 834 (Fla.Dist.Ct.App.1982). The court held that the business decision of Simon was neither unreasonable nor arbitrary, based on the facts presented.
2. ***Conspiracy.*** Titze also argued that Simon and Lamar engaged in a civil conspiracy. Under Florida law, Titze had to prove that Simon and Lamar acted in concert to achieve a result that, even if lawful, was obtained by unlawful means. *Kee v. Nat'l Reserve Life Ins. Co.,* 918 F.2d 1538, 1541 (11th Cir. 1990). The court held that Titze failed to produce any evidence that Simon and Lamar conspired to thwart Titze's contract with Lamar, and that Simon and Lamar exercised rights they possessed by virtue of their contracts with Titze.

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From Canada

Conditions Precedent and the Nonpayment of Rent in a Commercial Lease: *Calloway REIT (Westgate) Inc. v. Michaels of Canada*

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Introduction

Often, commercial leases contain clauses setting out conditions precedent to the payment of rent. For example, a lease for a large anchor tenant may make the payment of rent conditional on whether the landlord fulfills certain construction obligations. Similarly, a co-tenancy clause in a commercial lease may allow the tenant to not pay rent until another tenant has moved into the shopping centre and commenced its operations. These types of clauses share a common characteristic: They all rely on the occurrence of a triggering event before the obligation to pay rent is engaged.

Interpreting the Triggering Event

The wording and the clarity of the lease clause setting out the parties' respective rights in contemplation of the triggering event occurring (or not occurring) is of paramount importance. The key principle of contract interpretation is determining the parties' intentions.[1] Where the agreement is clear and unambiguous, Canadian courts are reluctant to look beyond the written words expressed in the contract itself to determine intention. However, in those cases where a lease clause is not so clear regarding when a rent-triggering event occurs (and therefore when the obligation to pay rent arises), the courts will strive to interpret these clauses in a way that ensures a fair result. Nowhere is this clearer than in the recent Ontario case of *Calloway REIT (Westgate) Inc. v. Michaels of Canada*.[2]

Case Facts

The dispute was as to whether the tenant, Michaels, a sophisticated Canadian retailer selling arts and crafts materials from over 900 stores throughout North America, was required to pay rent—despite the fact that construction of the shopping centre was not fully completed. The landlord was developing a big-box shopping centre in several phases. The tenant agreed to lease space in one of the early phases. The lease, which was the tenant's standard form lease, was one of nine similar leases entered into with the landlord's leasing agent for several different locations involving similar construction projects. The lease obliged the tenant to commence paying rent on the "Rental Commencement Date." However, the Rental Commencement Date would not be triggered until the later to occur of certain events. In one provision, the triggering of the Rental Commencement Date was made contingent on Wal-Mart's commencing its operations in the shopping centre and completion of the shopping centre (as the term "completion" was defined in the lease). In another, the Rental Commencement Date would be engaged on the earlier of the date the tenant commenced its operations or 60 days after the "Completion Date," the definition of which required that certain "Initial Required Common Areas" be completed.

The contemplated date for completion of the tenant's premises was March 31, 2007. On March 2, 2007, the landlord gave the tenant notice that the Completion Date would be April 30, 2007. The tenant carried out an inspection of the premises on May 2, 2007, and delivered a list of outstanding construction items to the landlord. On May 17, 2007, the landlord confirmed that all items on the list were completed, but the tenant did not accept keys to the premises until May 30, 2007. The tenant opened its store for business a few days after it took possession, and then refused to pay rent until construction of the *entire* shopping centre was completed. More than a year after the tenant took possession of the premises, and having paid no rent during the entire period of its possession, the landlord brought an action against the tenant for the payment of rent.

The Parties' Positions

The landlord and tenant took opposing views on the interpretation of "Completion Date." The landlord maintained that the lease did not require that the *entire* shopping centre be constructed before the tenant was obliged to pay rent. According to the landlord, the completion of the leased premises and certain common areas satisfied the requirements of the Completion Date and triggered the tenant's obligation to pay rent. In the landlord's view, the tenant understood that the shopping centre was to be developed in phases, in the same manner as the nine other leases that the parties had entered into (at different locations). This view was supported by the distinctions made in the lease between different common areas and their respective completion dates.

The tenant claimed that the Completion Date referred to all buildings in the shopping centre and was not limited to the construction of only certain aspects of it. The tenant claimed that, despite taking possession of the premises, it was not obliged to pay rent until the *entire* shopping centre was completed. Furthermore, the tenant differentiated the subject lease from the nine other leases on the basis that, at this location, there was a much longer delay between the completion of the premises and completion of the shopping centre.

Determining the Completion Date

In finding that the entire shopping centre did not need to be completed before the obligation to pay rent was triggered, the lower court and Court of Appeal highlighted several important points that are relevant to drafting these types of lease provisions. The considerations highlighted by the lower court and Court of Appeal indicate that courts may struggle to forge an interpretation, where the intention of the parties does not emerge very clearly.

The Interpretation Must Both Be Commercially Sensible and Avoid Absurdity

According to the tenant's interpretation, the tenant would be entitled to have possession of the premises on a rent-free basis up until the time that the shopping centre was complete, despite being fully operational. Further, the tenant would be entitled to deduct from its rent obligations after the Completion Date, as liquidated damages, an amount equal to the rent payable during the period between the date that the leased premises was complete and the Completion Date. In other words, the tenant's interpretation would entitle it to a rent-free period both before and after the Completion Date.

The decision in *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust*[3] was cited by both the lower court and the Court of Appeal for the proposition that commercial agreements must be interpreted in a manner that accords with good business sense and avoids commercial absurdity. Applying that principle of interpretation, the lower court rejected the interpretation advanced by the tenant, as it failed to accord with good business sense. According to the lower court, it would not make good business sense to entitle the tenant to extensive periods of rent-free possession of the premises while also being open for business.

The Court of Appeal, by contrast, stated that it would not be commercially reasonable simply to *ignore* the provision in the lease that required all buildings and other listed structures to be built before the Completion Date and, correspondingly, the obligation to pay rent was engaged. However, the Court of Appeal also stated that it would not be commercially reasonable to interpret the Completion Date and Rental Commencement Date in a way that would entitle the tenant not to pay rent—despite taking possession of the premises, carrying on business in the premises and accepting services from the landlord. In the end, the Court of Appeal was not inclined to make an interpretation based purely on commercial reasonableness.

A Co-Tenancy Clause Does Not Always Work in Favour of a Tenant

The Rental Commencement Date included, as one of several triggering conditions, an initial co-tenancy requirement that made the payment of rent contingent on the Wal-Mart store's being open.

A typical co-tenancy clause provides that if a landlord does not maintain a certain threshold level of occupancy in the shopping centre, the tenant will be entitled to a reduction in rent and/or termination of the lease. One of the purposes of a co-tenancy clause is to provide some assurance to a tenant that it will have the benefit of cross-over traffic from particular tenants and/or an exit strategy in the event that the shopping centre is no longer viable. Although a co-tenancy clause is typically used to protect the interests of a tenant, its inclusion in the lease in the *Michaels* case actually worked to support the arguments advanced by the landlord. Because Wal-Mart had in fact opened for business in January of 2001, well before the landlord and tenant entered into the lease, the lower court used the co-tenancy clause for another purpose. Noting that the co-tenancy clause was limited only to Wal-Mart's opening for business, but that Wal-Mart had already opened at the time the lease was signed, the lower court drew the conclusion that the tenant had not bargained for cross-over traffic. The landlord argued that both parties knew that the construction would proceed in phases. There was an understanding that the payment of rent was not made contingent on all buildings and common areas of the shopping centre being completed and occupied.

The lower court noted that the lease explicitly carved out certain common areas in the development from having to be completed by the Completion Date. Incomplete construction of these common areas would have prevented other tenants from having parking and reasonable access to their premises, thus further confirming that the tenant had not bargained for cross-over traffic in its co-tenancy clause and that completion of the entire shopping centre was not a precursor to the payment of rent. In effect, the lower court's interpretation of the co-tenancy feature of the lease played a key role in shaping the "factual matrix" to support the landlord's claims.

Once again, however, this factor was not recognized as a prevailing consideration by the Court of Appeal.

The Conduct of the Parties May Indicate a Waiver of Strict Compliance

A party to an agreement has a range of options available to it when the other party to the contract has not strictly complied with the terms of the agreement. For example, it may be able to accept the act of the other party as a repudiation of the contract and terminate the agreement and/or exercise certain remedies provided for under the agreement. However, where a party has, through its words or conduct, indicated that it has waived or suspended strict compliance with the terms of an agreement, the ability to compel strict compliance can later be lost or prohibited without first providing the defaulting party with notice that the non-defaulting party wants to revert to its strict legal rights.

In *W.J. Alan & Co. Ltd. v. El Nasr Export Import Co.*, the court defined "waiver" as follows:

> If one party by his conduct leads another to believe that the strict rights arising out of the contract will not be insisted upon, intending that the other should act on that belief, and he does act on it, <u>then the first party will not afterwards be</u>

> allowed to insist on the strict legal rights when it would be inequitable for him to do so... There may be no consideration moving from him who benefits by the waiver. There may be no detriment by him by acting on it. There may be nothing in writing. Nevertheless, the one who waives his strict legal rights cannot afterwards insist on them. His strict rights are at any rate suspended so long as the waiver lasts. He may on occasion be able to revert to his strict legal rights for the future by giving reasonable notice in that behalf, or otherwise making it plain by his conduct that he will thereafter insist upon them….[4] [Emphasis added]

The lower court did place some value on the evidence that the tenant had entered into nine other leases with the landlord's leasing agent, each dealing with other phased development projects and containing similar provisions to those seen in the present case, noting that in all those cases, the tenant had commenced paying rent well before the shopping centre was entirely completed. However, the lower court's analysis did not rely on waiver in settling on an interpretation of the lease.

At the Ontario Court of Appeal, though, not only was the issue of waiver explicitly addressed in the appeal court decision, but it was the basis on which the court ruled in favour of the landlord. The appellate court observed that the tenant had accepted possession of the premises, opened its store for business and accepted services from the landlord, despite knowing that the shopping centre had not been fully completed. It concluded that, in such circumstances, "the tenant has effectively waived strict compliance by the landlord with its obligations to complete all the buildings as a condition precedent to the commencement of the tenant's obligation to pay rent."[5] Despite the Court of Appeal having found commercial unreasonableness in both parties' interpretations, it ultimately settled on the interpretation advanced by the landlord because of the tenant's waiver of strict compliance with the lease.

Conclusion

The decision in *Calloway REIT (Westgate) Inc. v. Michaels of Canada* is a shining example of how ambiguities, in lease provisions purporting to link the payment of rent to the fulfillment of certain conditions, can cause trouble. The application of principles of contract interpretation, in this case, was inconsistent as between the Lower Court and the Court of Appeal, even though each arrived at the same result. The outcome was undoubtedly disappointing to the tenant and a huge relief to the landlord, but it left the outside observer with one question: "Is this a good way to start off a long-term relationship"?

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[1] *Manulife Bank of Canada v. Conlin*, [1996] 3 S.C.R. 415 at para. 79.

[2] [2009] O.J. No. 761 (Sup. Ct.) (Hereinafter, "*Michaels*").

[3] (2007), 85 O.R. (3d) 254 (C.A.) (Hereinafter "*Ventas*").

[4] [1972] 2 Q.B. 189.

[5] *Supra* note 1, at para. 5.

Planning Act Procedure—Comment on *SmartCentres Inc. v. Toronto (City)*

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A recent case answered, in the affirmative, the question of whether § 26 of the *Planning Act* applies to a provincial plan conformity amendment.

In *SmartCentres Inc. v. Toronto (City)* [2010] O.M.B.D. No. 486, the Ontario Municipal Board (the "Board"), was presented with a unique procedural question: In adopting its Growth Plan conformity amendment, was the City of Toronto obligated to follow the more onerous procedural requirements of § 26 to the *Planning Act?* The Board's decision raises an interesting procedural issue regarding how provincial plan conformity amendments are to be handled at the municipal level.

Official Plan Amendment No. 72 (the "Official Plan") was enacted by the Toronto City Council (the "Council" or "City Council") on May 27, 2009. The amendment was enacted for the express purpose of bringing the City's Official Plan into conformity with the *Growth Plan for the Greater Golden Horseshoe*.

In processing OPA 72, the City followed the procedure prescribed by § 21 of the *Planning Act*, which incorporates, by reference, all of the procedural requirements of §17 of the Act. In layman's terms, the City enacted OPA 72 pursuant to the same procedure it would use for any other municipally initiated official plan amendment.

There were multiple appeals filed to the Board from the City Council's adoption of OPA 72, primarily on substantive grounds. However, one appeal (filed by Home Depot Holdings Inc.) challenged the process by which the City enacted OPA 72. According to Home Depot, the City should have followed the enhanced procedural requirements prescribed by § 26 and not the "normal" procedural requirements as set out in § 17.

Section 26 is often referred to as the Five Year Review section. It obligates the municipal council to turn its mind to the need for amendments to its official plan at least once every five years. Section 26 was redrafted in its entirety by Bill 51 (in force as of Jan. 1, 2007). New subparagraph 26(1)(a) makes specific reference to the need for the Council to amend its Official Plan to ensure that it conforms with provincial plans, matters of provincial interest and provincial policy statements. New subparagraph 26(1)(b) further references amendments made to municipal official plan policies governing areas of employment.

By way of a motion before the Board, Home Depot asserted that, in enacting OPA 72, the City was adopting an amendment that fit within new § 26. As such, the City was obligated to follow the enhanced public consultation procedure prescribed by that section, which includes holding a special Council meeting, holding one or more open houses, and forwarding the amendment to the Minister of Municipal Affairs and Housing for final approval.

The City resisted Home Depot's motion, arguing that new § 26 still applies only to five-year reviews. While acknowledging that § 26 now specifically contemplates provincial plan conformity amendments, the City asserted that it retains discretion as to whether it will combine a provincial plan conformity exercise with a five-year review. As the City chose not to combine its Growth Plan conformity exercise with its five-year review, the City argued that the Council was at liberty to pass its conformity amendment pursuant to the normal procedural requirements as set out in § 17.

During the hearing of Home Depot's motion, the City summoned two staff planners from the Ministry of Municipal Affairs and Housing. Both planners gave evidence that the Ministry had not objected to the City's "choice" to follow the procedure prescribed by § 17. However, both planners agreed, on cross-examination, that the Ministry had not taken an official position on which procedure (§ 17 or § 26) applied to the adoption of a stand-alone provincial plan conformity amendment.

The Board ultimately agreed with Home Depot, holding that new § 26 demonstrates a "*willingness and desire on the part of the Province to enhance the consultative process,*" particularly with respect to provincial plan conformity amendments. The Board further held that new § 26 indicates that the Province is to exercise control over the implementation of a conformity amendment by being the final approval authority. These new directives are not achieved if the Council is permitted to adopt conformity amendments outside of the procedure prescribed by § 26.

As the amendments contemplated by OPA 72 were within the four corners of subsection 26(1), and as the City had not followed § 26 in enacting OPA 72, the Board held that the City's Growth Plan conformity amendment could not be approved.

The City is seeking leave to appeal the Board's decision to the divisional court. The leave motion was scheduled to be heard in December 2010; however, at the City's request, the motion was deferred into 2011. The City requested the deferral to allow its new Council to consider the divisional court's recent decision in *The City of Toronto v. Home Depot Holdings Inc.*, 2010 ONSC 1669 (CanLII), wherein the divisional court found that a major retail application approved pursuant to one of the employment area policies the City proposes to delete through OPA 72 (Policy 4.6.4) would not conflict with the Growth Plan.

If it is heard, at issue on the City's motion for leave will be the appropriate interpretation of § 26 of the *Planning Act* and whether a municipal authority is obligated to follow the enhanced procedural requirements of that section when it adopts a stand-alone provincial plan conformity amendment. Also at issue will be the level of deference the courts owe to the Board on issues involving the interpretation and application of the Board's "home statute" (i.e., the *Planning Act*). An update to this article will follow once a final resolution is reached.

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