THE SHOW MUST GO ON: CO-TENANCIES IN SHOPPING CENTRE LEASES

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# THE SHOW MUST GO ON: CO-TENANCIES IN SHOPPING CENTRE LEASES

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ANCHORS AWAY – WHERE DID ALL THE BIG BOXES GO?
THE IMPLICATIONS OF CO-TENANCY CLAUSES

by Janet Derbawka, McMillan LLP

Introduction

Shopping Centres have traditionally been built around the concept that there is safety in numbers and that stores perform best in the presence of complementary retail uses with the cornerstone being one or more “anchor” tenants, which draw customers to the shopping centre thereby increasing revenues for both landlord and tenants. There are those that argue that a tenant’s entry into a shopping centre is a marketplace risk and not a landlord risk and there should be no co-tenancy protection at all. They argue that the tenants can sufficiently assess the centre, surrounding demographics and the proposed tenant space in the centre prior to negotiating a lease. Nevertheless, landlords market their retail space based on the real or expected collection of tenants and retail uses in the development, and tenants enter into leases based on these representations. Co-tenancy provisions help protect the expectations of the tenant by ensuring that the shopping centre in which they find themselves remains consistent with the one originally marketed to them by the landlord.

Tenants want co-tenancy provisions, which may relieve them from being obligated to open, pay full rent or be bound by the lease in the event that the performance of a centre is not what the landlord promised or the tenant is anticipating. Landlords don’t want co-tenancy provisions because they can significantly impact a centre’s income stream and viability for reasons that are arguably outside of the landlord’s control.

Co-tenancy provisions are typically tied to the presence of certain “key” tenants so-called because they are viewed by the tenant seeking co-tenancy as “key” to the success of the centre. Co-tenancy provisions can also require an occupancy threshold based on a certain percentage of tenants or a percentage of the leasable area in a shopping centre being open and operating. Co-tenancy provisions can take various forms, but in their simplest form typically allow a tenant to (a) delay possession, (b) obtain a reduction in rent, and/or (c) terminate the lease if a key tenant or a certain number of tenants leave or fail to occupy the retail development.¹

In recent years, co-tenancy provisions can also be viewed as a sort of quasi-insurance scheme against the changing landscape of the retail industry. The combined forces of globalization and technology have ushered in new economic realities that have forced retailers to increasingly consolidate their physical locations,² which in turn can jeopardize the ongoing performance of

² Emanuel Halper “Supermarket Use and Exclusive Clauses, Part Two—The Industry Gains a Foothold” (2005) Real Property, Probate and Trust Journal at 262 [Halper].
neighboring tenants if an anchor tenant departs. In 2015 alone, Loblaw announced plans to close 52 unprofitable stores and Target wound up its operations in Canada. Accordingly, as the commercial landscape for retailers in Canada continues to change and develop, co-tenancy provisions will continue to be an important point of negotiation for both landlords and tenants.

Types of Co-Tenancies

The ability of a tenant to negotiate the inclusion of co-tenancy provisions in its lease depends on a variety of factors, including the tenant’s relative bargaining power and the nature, maturity and expected or current tenant mix of the retail development. Where successful, co-tenancy provisions usually take one or more of the following forms:

1. **Initial Co-tenancy**—An initial co-tenancy grants a tenant the right to refrain from taking possession of the leased premises and/or opening for business until a designated tenant or tenants are open and operating, the shopping center has achieved a certain level of occupancy and/or construction or certain phases of construction of the retail development have been completed. For example, a tenant’s lease may require that one or more named co-tenants take possession and commence operations before the tenant is required to accept possession of the premises. Initial co-tenancy is generally reserved for new shopping centers or redeveloping shopping centers, and protects a tenant from investing capital or incurring expenses prior to the shopping center being ready for occupancy. These provisions come in two varieties: opening co-tenancy and rent commencement co-tenancy. In the former, the tenant will not be obligated to open until the co-tenancy conditions are met, while under the later, the tenant will be entitled to reduced rent until such time as the co-tenancy requirement is satisfied.

2. **Continuing or Operating Co-tenancy**—An operating co-tenancy obligates the landlord to retain certain designated tenants (or categories of tenants or retail uses) and/or maintain a minimum level of occupancy within the shopping center during the duration of the tenant’s lease agreement. Some landlords also seek to satisfy the key tenant requirements by agreeing that a minimum number of key tenants out of a pool of key tenants will be open and operating (for example, 3 of 6 key tenants). A sub-type of the operating co-tenancy is

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6 Hamada, supra note at 9.


8 Ibid.


10 Ibid.

11 Ibid.
sometimes negotiated in a continuous occupancy clause, whereby the tenant agrees that it will
open and operate as required by the lease provided that a certain percentage of the gross leasable
area of the retail centre or a certain percentage of tenants are also open and operating. 12

3. **Hours of Operation Co-tenancy**—Under this type of co-tenancy, the tenant is only
obligated to operate in the retail centre so long as the other tenants in the centre maintain a
certain number of hours of operation.

4. **Construction Commencement Co-tenancy**—A construction commencement co-
tenancy is usually negotiated by a big box retailer, and only requires them to commence
construction on a ground lease or reverse build-to suit lease after a certain number of co-tenants
or a percentage of the overall gross leasable area of the retail centre is under construction.

**Considerations When Negotiating and Drafting Co-Tenancy Provisions**

Within these four types of co-tenancy provisions, there are variety of issues and considerations
that may apply when negotiating and drafting co-tenancy provisions, including:

(a) the nature of the co-tenants;
(b) replacement or substitution of a co-tenant;
(c) remedies for a breach of the co-tenancy provisions;
(d) sunset clauses and curative provisions;
(e) continuous operating clauses; and
(f) financing.

Each of these issues and considerations are discussed further below:

**Nature of Co-Tenants**

Traditionally, co-tenancy provisions either named an anchor tenant that belonged to a national or
regional retail chain or provided for a specific class of use (for example, a grocery store or a
department store). 13 Increasingly, the approach has tended towards greater flexibility. If the
concept of an anchor tenant is retained, anchor tenants should be defined flexibly with reference
to factors such as: (a) minimum number of stores, (b) an established operating history, (c)
minimum annual gross sales, (d) occupation of a minimum amount of gross floor area, and/or (e)
a specified percentage of the gross leasable floor area leased, occupied and open for business. 14

13 M Rosie Rees & Stephanie J Kim, “Enforcement of Co-tenancy Remedies: A Review of Grand Prospect Partners,
L.P. v. Ross Dress for Less, Inc” (2015) 35 Shopping Center Legal Update at 9 [Rees & Kim].
14 Janis B Schiff, *The New Normal in Real Estate Development and Leasing* online: Washington Business Journal online:
<www.hklaw.com> [Schiff].
For an example of this more flexible approach, a co-tenancy provision may define an anchor tenant as a national retailer with more than 25,000 square feet of floor space.\footnote{Darnell Little, “Main Street goes mainstream: with their Main Street” (2006) 71 Journal of Property Management at 37 [Little].}

An increasing number of leases with co-tenancy provisions are abandoning the notion of an anchor tenant all together. Within this paradigm, the “co-tenancy” instead mandates a certain number of stores with specified uses at a shopping center: for example, at least one national clothing store and at least one computer or electronics store.\footnote{Simmon & Taylor, supra note 3.} These types of provisions are more common in “lifestyle centre” leases, commercial villages developed in affluent areas that have large trade areas from 150,000 to over 500,000 square feet.\footnote{Little, supra note 15 at 37.} Lifestyle centres focus heavily on the visitor experience, and, as a result, contain a mix of restaurants and entertainment venues, and generally use restrictive covenants in their leases that specify that co-tenants must be other similar, upscale, specialty retailers.\footnote{Ibid.} For lifestyle centres, co-tenancy provisions may focus more on occupancy and retailer mix, rather than the traditional concept of an anchor tenancy. The International Council of Shopping Centers estimates that there are approximately 150 lifestyle centres currently in operation, with many more under development, suggesting that adapting co-tenancy provisions to these types of retail developments will continue to be important.\footnote{Ibid at 35.}

Unsurprisingly, when required to give co-tenancy provisions, landlords will push to keep the description of co-tenants as broad as possible, to allow the landlord to quickly cure a co-tenancy failure. Tenants, however, are often motivated to keep the definition of an anchor tenant more specific, particularly if the anchor tenant has unique attributes that benefit the tenant’s business.

Replacing a Co-Tenant

A related issue to defining what constitutes a co-tenancy is the issue of replacing or substituting a co-tenant. This issue most commonly arises where the lease contains a named co-tenant or a specific category of co-tenant. A landlord without the express right to replace the named co-tenant can be in an untenable position if the named co-tenant, or the co-tenant in a required category goes bankrupt or otherwise ceases to operate.\footnote{Simmons & Taylor, supra note 3.} [For an example of this see the case of Kleban Holding Co. LLC v. Ann Taylor Retail, Inc. discussed later in this paper]. Accordingly, the right to replace a co-tenant should be seen as an essential corollary in any co-tenancy provision, particularly where the lease contains one or more named co-tenants or a narrowly prescribed category of co-tenant.

For landlords, there are a number of pitfalls that should be avoided when negotiating and drafting replacement provisions. First, a landlord should resist naming a specific co-tenant in the lease, particularly where that co-tenant does not have an additional obligation to remain open or operate or related indemnities.\footnote{Seeberger, supra note 9.} Second, landlords should equally resist replacement clauses that
require a replacement co-tenant that operates in the same business category. Such provisions can hinder the landlord’s ability to find a replacement tenant, particularly if there is a sector wide downturn. For example, a landlord would not want to be bound to replace a 50,000 square foot grocery store with another 50,000 square foot grocery store, as the business reasons causing the first to close can often be applicable to another retailer with a similar business model.

Accordingly, the preferred approach for landlords when considering how to replace a co-tenant should focus on generic factors, such as national operational or financial indicia as the desired attributes for the named co-tenant. For example, a replacement co-tenant could be required to meet certain operational thresholds such as a minimum number of stores operating within Canada, minimum net worth or gross revenues. Also, landlords should seek to include an option to replace a large co-tenant (for example, one occupying 50,000 square feet or more) with several replacement co-tenants that each occupy a minimum size. These types of provisions are particularly useful in case of ‘big box’ tenants, and landlords should aim to negotiate the right to break up large spaces and replace co-tenants with general categories like “national retailers” so that a large store can be replaced by three or more smaller national retailers in any category. This approach is particularly relevant at present since several national retailers have announced plans to reduce their overall lease footprint in the coming years.

Tenants, on the other hand, will want to negotiate narrower replacement clauses that require a landlord to substantially comply with the original bargain when the parties entered into the lease. Drafted too generically, a co-tenancy provision could allow for absurd or unintended substitutions that do not align with the tenant’s business needs. Accordingly, tenants should seek to link co-tenancy provisions to specific uses and push to include specific financial and commercial attributes that must be met for any replacement co-tenant.

Remedies

Several remedies can accompany co-tenancy provisions, which vary depending on the nature of the co-tenancy provisions. The standard remedies are alternate rent and rights of termination, but these can be combined in various permutations or added to depending on the negotiations between the parties. Common remedies include:

1. **Reduction in Rent**—An alternate (i.e. reduced) rent remedy gives a tenant either a reduction in the base rent payable under the lease or eliminates base rent and requires the tenant to pay a lower percentage of gross sales than otherwise would be payable during the continuance of the co-tenancy failure. In some cases, particularly if a co-tenancy failure continues for an extended period of time, a tenant may negotiate full rent abatement as a remedy, which is a more common remedy in opening co-tenancies. As a pre-condition to this remedy, a landlord may require a tenant to demonstrate that the co-tenancy failure caused an economic impact by comparing gross sales prior to the failure to gross sales after the failure. When pre-conditioned

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22 Simmons & Taylor, supra note 3.
23 Schiff, supra note 14.
24 Ibid.
25 Seeberger, supra note 9.
26 Simmons & Taylor, supra note 3.
upon actual loss, both landlords and tenants should exercise caution and carefully consider what metrics will be used, how to resolve disputes and inspection and audit rights. Whatever alternate rent structure is agreed upon, landlords should insist that a tenant continue to pay additional rent, as a tenant in possession will incur expenses relating to the operation and maintenance of the retail centre.  

2. **Termination of Lease**—Tenants may also seek a right to terminate the lease on a co-tenancy failure on the basis that the failure has substantially altered the terms of its original bargain with the landlord. This remedy is often included as the ultimate remedy, triggered after a series of escalating remedies over the course of the co-tenancy failure. A termination right may not, however, make the most sense if the tenant has already spent money on its leasehold improvements when the time comes to evaluate the co-tenancy threshold (on opening for instance). By that stage, the tenant’s only concern is rent. As discussed further in relation to sunset provisions, landlords usually want to force the tenant to choose to terminate the lease upon failure of a co-tenancy, rather than continue indefinitely at reduced rent. A landlord’s rationale in this is that the tenant has had the opportunity to operate during the co-tenancy failure and can generally judge whether the impact has been great enough to require an exit from the retail centre. If they choose not to leave, then the tenant should commence paying full rent.

3. **Delay in Opening / Possession**—This remedy only arises in the context of initial co-tenancy provisions, and allows a tenant to delay the date of possession, date of opening and/or the rent commencement date. However, in opening co-tenancies, most tenants will also seek to have the right to open, but with rent abatement as set forth above.

4. **Right to Go Dark**—The right to go dark can be added to an operating co-tenancy and allows the tenant to close its store, limiting its operating expenses while the co-tenancy failure is continuing. Typically, the landlord will insert clauses that make the tenant choose between enjoying alternate rent or going dark, but will not allow the tenant to claim both remedies simultaneously. If a right to go dark is advanced during negotiations by the tenant, landlords should insist on adding a right to terminate the lease if the tenant ceases operations for an extended period of time. As discussed later in this paper, this can be a dangerous remedy for landlords to grant as allowing a tenant to go dark can trigger a breach of other tenant’s co-tenancy provisions requiring a certain percentage of the gross leasable area of a centre or a certain percentage of tenants to be open and operating.

5. **Reimbursement for Leasehold Improvements**—If either party terminates the lease due to a co-tenancy violation, the landlord or the tenant may want to be reimbursed for the unamortized leasehold improvements (typically amortized on a straight-line basis over the initial term).

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28 Rees & Kim, supra note 13 at 10.
Sunset/Curative Provisions

Sunset and curative provisions are landlord-friendly provisions. Such provisions acknowledge that even the best laid commercial plans can change unpredictably, and operate to transfer some of this risk back to the tenant.

Sunset provisions can take at least two forms. First, a sunset clause can limit the amount of time a tenant can enjoy a remedy for a co-tenancy failure. At the end of the remedy period, a sunset clause will require the tenant to choose between: (a) cancelling its lease, (b) taking possession of the premises or opening (in the case of initial co-tenancies), or (c) reverting to full base rent (in the case of an operating co-tenancy provision). The landlord’s rationale behind such clauses is that it would be imprudent to have a tenant occupy space indefinitely without opening or paying reduced rent. If a tenant does not terminate, then the tenant is showing that it still wants the location and should return to full base rent payments. Anything else would fall outside the parameters of the original bargain the parties negotiated. Sunset provisions hinge on notice. Landlords are generally motivated to require the Tenant to provide notice of its election shortly after the right to terminate has accrued (i.e. to terminate or revert to the original lease).

The second type of sunset provision is on the co-tenancy provisions themselves. In these types of sunset clauses, the landlord will typically set up a condition that, once fulfilled, will prevent the tenant from exercise any co-tenancy rights. These types of sunset provisions are often included with renewal or extension provisions, and expressly provide that the co-tenancy provisions will not continue. Other potential conditions could include occupancy over a certain threshold, completion of all phases of construction, time from the commencement date or various combinations of these factors.

Landlords should additionally seek to protect themselves by adding curative provisions. Curative provisions operate as conditions precedent to a tenant’s remedies for a co-tenancy failure. The oft-cited condition is that the tenant should not be in default under the lease. Other similar conditions may include: (a) that the tenant itself be operating at the time of a violation of the co-tenancy provision; and (b) that the tenant show a drop in sales during the co-tenancy violation period as compared to the period prior to the violation. In addition, landlords should ensure that they have a cure period prior to the tenant being entitled to any remedy for a co-tenancy failure.

In addition to sunset and curative provisions, there are a variety of other strategies landlords can use to limit their liability. For example, the landlord can provide that any remedy elected by the tenant for a co-tenancy failure is the tenant’s sole remedy.\(^{30}\) Also, the landlord can seek to negotiate a cancellation penalty from the tenant for the unamortized costs for tenant improvements and real estate commissions.\(^{31}\)

\(^{30}\) *Ibid.*

\(^{31}\) *Ibid* at 45.
Considerations for Leases with Anchor Tenants: Continuous Operating Clauses

When a named anchor tenant ceases operations or fails to occupy a retail centre, it usually results in the loss of one of the main driving forces bringing customers to the shopping center. This often has a cascading effect, where the landlord, in addition to lost rent, may suffer increased insurance costs, reduced rent or termination by other tenants with co-tenancy clauses, and heightened risk that other tenants may fail or abandon their leases, which can ultimately lead to the closing or failure of the entire retail centre.

To mitigate these risks, landlords often seek to expressly oblige key tenants to operate their business in the premises throughout the term of the lease. These provisions are often referred to as continuous operating clauses, which help ensure the presence of an active and operating tenant for the duration of the term. Continuous occupancy provisions provide some insurance to the landlord against losses it may suffer under any co-tenancy provisions in its other leases, since the lease with the key tenant will also usually contain an indemnity or a guarantee of the tenant’s obligations under the lease.

In practice, continuous operating clauses may provide little comfort. In the recent Target Canada restructuring (described further below), the court issued a temporary stay of the rights of Target Canada’s landlords to claim an indemnity or call on the guarantee of Target Canada’s parent company for breaching a continuous operating clause, because granting such rights would threaten the ability of the anchor tenant to effectively restructure. A recent attempt by Target Canada and its parent to limit the liability under this guarantee was rejected by the court.

Financing

Co-tenancy provisions present financial risks to landlords, and lenders are increasingly attuned to co-tenancy issues in retail developments. Lenders financing a retail centre that relies heavily on one anchor tenant will be concerned about financial risks, particularly where there are co-tenancy provisions that would substantially reduce the landlord’s rental revenue on the departure or bankruptcy of an anchor tenant. To limit these risks, lenders may set parameters for the landlord when negotiating co-tenancy provisions. Also, as a sub-issue, certain lenders may have provisions in their loan documents that prohibit significant changes to the property without the lender’s consent. With some forms of securitized loans, obtaining consent to make significant changes can be a long and cumbersome process that can be a significant barrier to finding an appropriate replacement tenant. This situation is most likely to arise in the case of large big box stores where the landlord has significantly improved the leased premises to meet specific needs of the tenant, and the landlord seeks to break the space into three smaller stores. Where these facts exist, landlords should carefully review and consider their obligations to their lender when negotiating co-tenancy remedies.

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34 Little, supra note 15 at 37.
35 J Adam Rothstein, “Bring It Back from the Dead: Issues in Resurrecting the Distressed Center” (2014) 28 Probate & Property Magazine at 6 [Rothstein].
Litigation

Canadian Case Law

Canadian jurisprudence considering co-tenancy clauses is not as common as it is in the United States. Interestingly, when two of the largest retailers in Canada restructured (and ultimately closed) their operations each of such retailers utilized the provisions of the Companies Creditors Arrangement Act 36 (the “CCAAs”) to stay any ability of other tenants to take any proceedings or exercise any rights or remedies against their landlords as a result of the retailer’s restructuring. These orders may have reduced or eliminated the ability of tenants to enforce co-tenancy provisions as against their landlords. The Target stay discussed below has been recently extended until March 16, 2016. It will be interesting to see what, if any, actions arise after the stay is ultimately lifted.

T. Eaton Co., Re 37

T. Eaton Company Limited (“Eaton”) entered into restructuring proceedings under the CCAA. The court permitted the company to present a plan of compromise and arrangement to its creditors. The order contained a clause preventing tenants at retail shopping centers in which Eaton was an anchor tenant from terminating their leases during the restructuring period. 38 However, the defendant tenant was not served with the original notice of the application and could apply for variation as a result. 39 The tenant brought a motion to vary the order to allow it to exercise its co-tenancy rights. However, the motion was dismissed. 40 The court stated that if it were to grant the order it would have to grant the same relief to other tenants in similar positions. 41 If this were to happen, Eaton’s restructuring plan would be seriously jeopardized. In giving this order, the court noted that it had jurisdiction to make the order as section 11 of the CCAA, together with the inherent jurisdiction of the court, gave the court sufficient authority to make orders against third parties who were not creditors. 42 An additional factor that swayed the court’s opinion was that no stores had yet been closed and the defendant had not suffered any prejudice. 43

Implications: A tenant’s rights upon a co-tenancy failure can be limited by restructuring proceedings under the CCAA.

Target Canada Co., Re 44

Target sought to wind down its Canadian operations and applied for relief under the CCAA proceedings. Many of Target’s landlords had leases with third-party tenants that contained co-tenancy clauses that would have been triggered upon Target closing its stores. In order to alleviate the financial distress incumbent upon the landlords if any non-anchored were to

36 RSC 1985, c C-36.
38 Eaton, supra note 37 at para 1.
39 Ibid.
40 Ibid at para 8.
41 Ibid at para 7.
42 Ibid at para 6.
43 Ibid.
44 2015 ONSC 303, 22 CBR (6th) 323 [Target].
terminate their leases, the Ontario Supreme Court granted a stay of proceedings.\textsuperscript{45} The court found jurisdiction under section 11 of the \textit{CCAA} and its inherent jurisdiction, as the court in \textit{Eaton} had done.\textsuperscript{46} In granting the stay, the court kept open the possibility that affected parties could challenge the stay at a comeback hearing.\textsuperscript{47}

Since the original stay in \textit{Target} on January 15, 2015, the Court has continued to extend the general stay. As of the time of writing, the stay has been extended until March 15, 2016.

\textbf{Implications:} As in \textit{Eaton}, a tenant’s rights upon a co-tenancy failure can be limited by restructuring proceedings under the \textit{CCAA}.

\textit{Grant Park Shopping Centre}\textsuperscript{48}

The landlord sued the tenant for failure to pay rent and associated costs. The tenant disputed claim, arguing that its lease renewal contained an implied term that the anchor tenant would continue to operate in the mall through the entire renewal period.\textsuperscript{49} However, prior to the lease renewal, the anchor tenant had decided to vacate the mall or was seriously considering leaving, and left after the renewal came into effect. The tenant alleged that the landlord wrongfully concealed this information, and stopped paying its rent as a result.\textsuperscript{50} The court allowed the landlord’s action for damages against tenant.\textsuperscript{51} In deciding for the landlord, the court held that the landlord did not conceal information regarding the departure of the anchor tenant, and that since the tenant knew or ought to have known regardless there was no concealment.\textsuperscript{52} The court also added that there was no justification to imply a co-tenancy provision in the lease,\textsuperscript{53} nor was there any evidence that the parties had intended to include an implied term.\textsuperscript{54}

\textbf{Implications:} Co-tenancy provisions are unlikely to be read into an agreement. If a tenant requires co-tenancy rights, it should negotiate and expressly include these in the lease.

\textit{Calloway REIT}\textsuperscript{55}

This dispute related to the interpretation of a shopping centre lease agreement. The question was whether the tenant was required to pay rent, despite the fact that construction of the shopping centre was not fully completed.\textsuperscript{56} The tenant argued that, per the wording the lease, rent should only commence when construction of the shopping centre was complete, and construction would

\textsuperscript{45}\textit{Ibid} at para 44.
\textsuperscript{46}\textit{Ibid} at paras 44, 48.
\textsuperscript{47}\textit{Ibid} at para 48.
\textsuperscript{48}\textit{Grant Park Shopping Centre v San Francisco Gifts Ltd., 2004 MBQB 109; 130 ACWS (3d) 1205 [Grant Park Shopping Centre].}
\textsuperscript{49}\textit{Ibid.}
\textsuperscript{50}\textit{Ibid.}
\textsuperscript{51}\textit{Ibid} at para 60.
\textsuperscript{52}\textit{Ibid} at para 31.
\textsuperscript{53}\textit{Ibid} at para 63.
\textsuperscript{54}\textit{Ibid} at para 65.
\textsuperscript{55}\textit{Calloway REIT (Westgate) v Michaels of Canada [2009] OJ No 761, 175 ACWS (3d) 553, aff'd 2009 ONCA 713 [Calloway REIT]}
\textsuperscript{56}\textit{Ibid} at para 44.
only be considered complete when all the buildings in the shopping centre had been fully constructed. In its submissions, the landlord argued that rent should commence when construction of the leased premises and the initial required common areas were completed, per the terms of the lease. The landlord also highlighted the fact that the form of lease had been used by the tenant in other dealings with the landlord, and that in prior dealings the tenant had started to pay rent well before all of the buildings and common areas were fully built out.

The court found for the landlord on both first instance and appeal. At first instance, the court focused on the fact that the tenant’s position did not accord with good business sense, as it would permit the tenant to occupy the premises rent free until the shopping centre was fully constructed, despite the tenant being fully operational and having the benefit of the common areas. On appeal, the court held that in instances of latent ambiguity, an interpretation should be reached that accords with good business sense and avoids a commercial absurdity. The court found that it was commercially absurd to allow the tenant to accept delivery of the leased premises, open its store and accept the landlord’s provision of services but then argue that rent was not payable.

Implications: Courts are unlikely to read co-tenancy provisions into a lease. If alternate rent or other inducements are intended, the parties need to expressly include these in the lease.

US Case Law – Two recent cases of note

**Grand Prospect Partners, LP v Ross Dress for Less, Inc. et al**

The recent Ross decision by California’s Fifth Appellate Court affirmed the enforceability of co-tenancy provisions but also called into question whether rent abatement provisions will be enforced, particularly in the context of initial co-tenancy provisions. This case is important because it was also the first time an appellate court in California considered enforceability of co-tenancy provisions. In Ross, the landlord agreed to a lease with Ross Dress for Less, Inc. (“Ross”) in 2008. The terms of the lease contained a co-tenancy provision that required the named tenant, Mervyn’s, located in the shopping center to be open and operating as of the commencement date under Ross’ lease. If this condition was not met, the co-tenancy provision allowed Ross to possess its leased premises rent-free, regardless of whether it opened its own store for business. Ross could continue to possess the property in this manner until landlord caused Mervyns or an alternate anchor tenant to open for business in the requisite amount of floor area. If landlord was unable to cure this situation within a period of 12 months following the lease commencement date, then at any time thereafter, but before the landlord found a replacement cotenant, Ross could terminate the lease upon 30 days’ notice. Mervyns filed for bankruptcy protection soon after the landlord had completed the tenant improvement’s for Ross.

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57 Ibid at para 49–54.
59 Ibid at para 76.
60 Calloway Reit (Westgate) Inc v. Michaels of Canada 2009 ONCA 713.
61 Ibid at para 2.
62 Ibid.
Ross accepted delivery of the premises but never opened for business or paid rent during the 13 months that it possessed the premises. During that period, Ross negotiated with the landlord for potential modifications to the lease to address the loss of Mervyn’s. Those negotiations included a proposal to convert the Ross lease from a net lease to a gross lease, at a lower overall rental rate. The landlord and Ross were unable to come to terms on a lease modification and, at the end of the 12-month period, Ross notified the landlord that Ross was terminating its lease under the operating co-tenancy provision. At this point, Ross had never taken possession of the premises nor paid any rent under the lease (Ross’s total rent for that initial year of the lease would have totaled over $650,000). In response to Ross’s termination notice, the landlord brought an action challenging the enforceability of both the opening and operating co-tenancy provisions in the lease and seeking both past and future rent and expenditures on tenant improvements from Ross. The trial court found the co-tenancy provisions unenforceable on the basis that they were unconscionable or unreasonable. The court then awarded the landlord $3.7 million in damages, which included lost rent over the term of the lease.64 Ross appealed.

The court of appeal partially overturned the original verdict, finding that the co-tenancy provisions were not unconscionable, but that the rent abatement provision operated as an unreasonable penalty against the landlord.65 In reaching this finding, the court noted that the parties were both sophisticated and had spent considerable time negotiating the lease. The court further found that the termination provision was enforceable against the landlord, as it did not cause the forfeiture.66 The court added that there was no forfeiture as the parties were sophisticated, had both agreed to the co-tenancy conditions, and neither had the right to control whether Mervyn’s continued to operate in the shopping center. A lease provision is a penalty, and is therefore void, when it requires a landlord to forfeit money or property without regard to the amount of damage that, at the time the parties negotiate the agreement, a tenant anticipates it might suffer due to the landlord’s noncompliance with that provision. The Ross rent abatement clause amounted to a penalty because the $39,500 per month in rent that the landlord lost due to Mervyn’s bankruptcy bore no reasonable relationship to the $0.00 in harm Ross anticipated it would suffer from the lack of an operational Mervyns or from Ross’s inability to open and operate a store in this location. Here, the balance between an outcome in favor of the tenant and one in favor of the landlord, was decided in favor of the landlord because the landlord had no control over whether Mervyns occupied or operated its business in the adjacent property. In another factor that might have swayed the court to ignore the contractual provisions, the court noted that the landlord had paid for over $2,300,000 in tenant improvements before Ross took possession of the leased premises. In end, Ross was held liable for the payment of rent until the date it terminated the lease.67

Implications: In opening co-tenancies, rent abatement provisions may not be enforceable. If negotiated, tenants should ensure these provisions include language that links rent abatement to the tenant’s liquidated damages. For landlords, this case illustrates the need to broadly define co-tenants such that key tenants can be replaced.

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64 Ibid at p 9.
65 Ibid at p 18.
66 Ibid at p 40.
67 Ibid at p 41.
Kleban Holding Co. LLC v. Ann Taylor Retail, Inc.\textsuperscript{68}

The Ann Taylor case is a cautionary note to landlords when negotiating co-tenancy provisions. In 2000, Ann Taylor Retail, Inc. ("Ann Taylor") negotiated and entered into a lease for retail premises, which was later assigned to Kleban Holding Co. LLC, as landlord. The initial term of the lease was ten years, and Ann Taylor exercised its option to extend on April 11, 2011.\textsuperscript{69} The lease contained opening and operating co-tenancy provisions. Although the initial co-tenancy provisions allowed the landlord to substitute three named co-tenants with "a suitable replacement tenant", the operating co-tenancy provision only provided that if Borders, Inc., a bookstore, ("Borders") or fifty percent of the other retail space is not open and operating, Ann Taylor was entitled to abated rent.\textsuperscript{70} On May 16, 2011, Borders closed its store in connection with its bankruptcy filing. The landlord replaced Borders with two other bookstores, which operated more or less continuously after Borders closed.\textsuperscript{71} However, Ann Taylor paid abated monthly rent starting in July 2011 up to the date of the decision, despite the landlord's argument that such an abatement would result in Ann Taylor being provided with an $800,000+ windfall. The landlord eventually sued, arguing a breach of the lease, anticipatory breach of the lease, and unjust enrichment.\textsuperscript{72}

The court held for Ann Taylor, and upheld its right to abated rent. In so finding, the court relied on the clear unambiguous language of the operating co-tenancy provision, finding the lease unambiguously set out the parties expectations and would be defeated by any other contractual interpretation.\textsuperscript{73} The landlord's arguments regarding unjust enrichment also failed because such an unjust enrichment claim is actionable in Connecticut only in instances where there was no valid lease or contract in place-unlike the scenario in this case. Lastly, because the lease contained an attorney's fees provision for the prevailing party, the Court requested that Ann Taylor submit evidence of attorney's fees for the Court's consideration. Implications: As Canadian principles of contractual interpretation and unjust enrichment differ from those in Connecticut, it is unclear whether a Canadian court would have reached the same result if deciding Ann Taylor. However, this case emphasizes that landlords should strongly insist upon flexibility in the definition of a co-tenant, as it could potentially result in a sizable windfall for the tenant with devastating effects on the landlord. Also, landlords should fight for a co-tenancy provision that contains an expiration date well short of the tenant's lease term or at least does not extend to renewals.

\textsuperscript{69} Ibid at 2.
\textsuperscript{70} Ibid at 2-3.
\textsuperscript{71} Ibid at 3.
\textsuperscript{72} Ibid at 4.
\textsuperscript{73} Ibid at 20.
Possession

Conditions
- Personal to Tenant?

Triggers
- Percentage of tenants by number obligated to open? Where? Whole shopping centre or just expansion?
- Percentage of tenants by GLA? Where? Whole shopping centre or just expansion?
- Required to be open on General Opening Date of expansion (GOD) or is within "x" days after GOD acceptable?
- Anchor tenants included in percentages? Which ones? Existing or expansion anchors or both? Named anchors or replacements acceptable?
- Are Tenant’s Premises in or out of GLA/store count?
- Is an LOI sufficient to meet threshold or do other tenants have to have signed binding LOI/lease to qualify?
- Are there "Key" named tenants who need to have committed? All required or just a percentage of named tenants/at least "x" open out of “y” Key tenants? Can landlord replace Key tenant(s) with tenants of similar quality of merchandise, style of operation, etc.?
- Trade name or legal name, i.e., will any division suffice or just one trade name?

Remedies until threshold met
- Tenant doesn’t have to take possession and commence construction?
- Tenant can take possession and commence construction but not required to open till thresholds met?
- Terminate lease? Mutual right? What’s a reasonable period of time for landlord to fix problem?

Other Considerations
- Is this subject to force majeure? Delays in getting municipal and other required approvals?
- If tenant fully builds store and ends up terminating, is there reimbursement for cost of building store? If so, is it subject to a cap? (Consider whether or not reimbursement is more appropriate for an opening co-tenancy requirement)
- If there is an on-going co-tenancy, does it align properly with opening co-tenancy?
- Landlord recapture rights? After how long?
- If Landlord recaptures, can Tenant opt to void notice and take possession, commence construction, etc?
- If Landlord has paid a portion of the tenant allowance, can it be recaptured?
Celia Hitch’s Co-Tenancy Decision Making Matrix

Opening

Conditions
- Personal to Tenant?
- Does Tenant need to open and operate regardless?

Triggers
- Percentage of tenants by number open? Where? Whole shopping centre or just expansion?
- Percentage of tenants by GLA? Where? Whole shopping centre or just expansion?
- Required to be open on General Opening Date of expansion (GOD) or is within "x" days after GOD acceptable?
- Are Tenant’s Premises in or out of GLA/store count? Are anchor tenants in or out of GLA/store count?
- Is signing a binding LOI sufficient to meet threshold or do other tenants have to be open? How to avoid everyone waiting for everyone else to open?
- "Key" named tenants open? All required or just a percentage of Key named tenants/at least "x" open out of "y" Key tenants? Can Landlord replace Key tenant(s) with tenants of similar quality of merchandise, style of operation, etc.?
- Trade name or legal name, i.e., will any division suffice or just one trade name?
- Anchor space open? Which ones? Existing or expansion anchors or both?
- Named anchors open?
- Combination of above, i.e., does satisfying one threshold satisfy requirement or do some or all need to be satisfied?

Remedies until threshold met
- Tenant doesn’t have to open and pay Rent?
- Tenant can or must open but pay Percentage Rent in lieu of Minimum Rent or in lieu of Minimum and Additional Rent or some combination of Percentage Rent and Taxes/Operating Costs?
- Terminate lease? Mutual right?

Other Considerations
- Does tenant get to terminate lease at some point? After how long?
- What if tenant is profitable anyway?
- If tenant has fully built store, is there reimbursement for cost of building store?
- If landlord paid tenant inducement, will tenant repay any portion of tenant inducement?
- If there is an on-going co-tenancy, does it align properly with opening co-tenancy?
- Landlord recapture rights? After how long?
- If Landlord recaptures, can Tenant opt to open and commence paying full rent?
- If Tenant gives notice but Landlord remedies within notice period, is Tenant’s notice rendered void?
Celia Hitch’s Co-Tenancy Decision Making Matrix

On-Going

Conditions
- Personal to Tenant?
- Does Tenant need to be open and operating?

Duration
- First "x" years of Term?
- Initial Term?
- Term plus extensions?

Triggers
- Percentage of CRU's? If so, is it a percentage of GLA? or a percentage of stores?
- Who's in/out from CRU's? Include tenants normally excluded from Proportionate Share fraction (service, storage, etc)?
- Are Tenant's Premises in or out of CRU's?
- What is sufficient proof? Certificate of LL officer or higher threshold?
- Named "key" tenants? All or some fraction of "key" tenants?
- Trade name or legal name, i.e., will any banner suffice or just one specific trade name?
- Anchor space(s) closed?
- Named anchors closed?
- Combination of above?
- "and" or "or", i.e., just one trigger needs to occur for remedy to start to run or do more than one/all have to occur?
- Sales reduction?
- If sales reduction is a trigger, is it measured year/year last 12 months? Longer period? What's the appropriate percentage of reduction to ensure that it’s not just that the tenant is having a bad season or has missed its market with its most recent merchandise? Does it adjust if tenant is closed for renovation or otherwise during Y/Y period?
- Exclusion for premises which are temporarily closed for reno's/remerchandising/change of banner/casualty/force majeure?

Cure Period
- How long does landlord have to fix the problem?
- Is the cure period for GLA of CRU different from the cure period for anchor tenant, given how much longer it takes to source anchor tenants and fixture anchor space?

Remedies
- Rent reduction?
- Minimum Rent reduction?
- Percentage Rent in lieu of Minimum Rent?
- No Rent payable?
- Phased process, i.e., 75% of Minimum Rent for 6 months, then 50%, etc.?
- Lease termination? Is there a period of reduced rent before the termination or does termination just kick in?
Celia Hitch’s Co-Tenancy Decision Making Matrix

- Is there a period after which tenant can no longer exercise its termination rights, i.e., it’s presumed to have accepted the change in condition? Does tenant go back to regular Rent then?
- If Landlord rectifies co-tenancy failure during termination notice period, will it void notice?
- If Tenant terminates, will it repay any portion of tenant inducement?
- Landlord recapture rights? After how long? What triggers?
- If Landlord recaptures, can Tenant opt to reopen and return to full rent?

How Can Landlord Cure?
- If it’s an anchor tenant closure, what is a “suitable replacement”?
- Can Landlord replace with any tenant?
- Does replacement have to be in its entirety or is it sufficient to replace 50%? 75%? of existing anchor tenant space? Exclude areas such as basements which are only accessible through anchor store and not from Common Areas?
- Is a discount department store an acceptable replacement for a full-line department store?
- What if landlord has no control over identity of tenant of anchor store or use of anchor space?
- Can landlord “box out” the anchor space? Is there a maximum number of “boxes” permitted? Can the landlord make the balance into Common Area?
- Does it have to be a retail replacement? Can it be a “service” use, e.g., large walk-in medical facility? Storage (basement of former anchor store)? What about a church? A school??
- Can landlord move physical location of anchor store and it still counts?

Other Considerations
- If there is an operating co-tenancy, does it align properly with on-going co-tenancy?
- If Tenant exercises option to renew while co-tenancy provision is actively governing, does co-tenancy die?