

## Commercial Lease Absurdity

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In recent years many prospective residential house and condominium owners have endured significant delays in the construction of newly purchased property. The commercial real estate market has suffered similar delays. Commercial tenants often overlook the sections of a commercial lease dealing with commencement date of a lease for newly constructed premises. Implementation of these provisions can be confusing when certain milestone events in construction are delayed.

This issue was touched on in the recent Ontario Superior Court of Justice case, *Calloway REIT (Westgate) Inc. v. Michaels of Canada ULC* (February 2009) which was later affirmed by the Ontario Court of Appeal. In this case, Calloway ("Landlord") and Michaels ("Tenant") entered into a lease agreement dated December 19, 2005 (the "Lease"). The Lease was the Tenant's standard form lease that it had used with this particular Landlord on nine previous occasions and the leased premises in question were to be part of a phased shopping centre development. There were delays in the construction of the phase of the shopping centre in which the leased premises were to be located. The Landlord and the Tenant disagreed on the date when rent should commence.

The Tenant argued that, given the wording of the lease, rent should only commence when construction of the shopping centre was complete, and construction would only be considered complete when all the buildings in the shopping centre had been fully constructed. The Landlord countered that rent should commence when construction of the leased premises and the initial required common areas were completed. The Landlord further argued that, in the nine previous dealings with the Tenant, the Tenant started to pay rent well before all of the buildings and common areas were fully built out. The lease contained inconsistent and contradictory wording on the issue.

In finding for the Landlord, the Court was persuaded by the past conduct of the Tenant who, on occasions using the same lease with

the Landlord, had commenced paying rent well before the shopping centres were fully built out. In addition, the Tenant understood that the shopping centre was a phased development project and that rent should commence once another tenant, Wal-Mart, opened for business. Finally the Court determined that, although the terms of the lease were inconsistent, they favoured the position of the Landlord. The Court ruled that the Tenant's position did not accord with good business sense, because 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 Ontario Court of Appeal affirmed the lower court's findings. The Court of Appeal focused on the internal inconsistencies of the lease. The Court stated that in instances of latent ambiguity, an interpretation should be reached that accords with good business sense and that avoids a commercial absurdity. Latent ambiguity occurs when a conflict arises not at the time of the drafting of the lease, but later when events have evolved so as to create circumstances where a conflict arises. 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 because all the buildings in the shopping centre were not completed. A Tenant acting in this manner has waived strict compliance by the Landlord of obligations to construct all the buildings.

Parties to commercial leases should take note that, where the lease contains inconsistencies about the rent commencement date in a construction delay situation, a court might consider factors such as past conduct, good business sense and latent ambiguity, to decide the issue.

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