Be Careful How You Ask For What You Wish For:

Drafting Preconditions for Lease Renewal and Extension Provisions

By: Daniel Wiener

Minden Gross LLP, a member of MERITAS Law Firms Worldwide.

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When negotiating the terms of a commercial lease, one of the most coveted provisions for tenants is an option to renew or extend the lease. However, despite its significance and potential impact on both parties, this option is often not given due scrutiny.

Most extension and renewal rights are subject to certain pre-conditions, the most common of which is the provision whereby the tenant will lose its right to extend or renew if the tenant is in default at the time the option is exercised, or has been in default at any time during the term of the lease. While seemingly straightforward, the drafting and phrasing of these preconditions vary significantly from lease to lease. The judiciary has provided a great deal of insight into some of the variations of the "no default" pre-condition, which landlords and tenants would be wise to consult prior to drafting their extension or renewal rights.

"Duly and Regularly"

In *Sparkhall v. Watson* [1954] O.W.N. 101 (Ont. High Court) the lease contained a renewal option which was predicated on the tenant paying rent "duly and regularly". The lease provided a rent schedule whereby the tenant was to pay varying amounts of rent throughout the term of the lease. The tenant paid the rent in a non-uniform and sporadic manner, and in any event not in accordance with the terms of the lease.

The court concluded that the term "duly and regularly" meant that rent was to be paid in fixed intervals according to the rules established by the parties in the lease, which the court clarified as meaning "punctually, at the due date". In applying this strict and narrow interpretation of the condition precedent, the court noted that the tenant's breach was not a case of occasional, inadvertent or trivial default, but was a complete disregard of the purpose of meaning of the words set out in the renewal provision.

"Not in Default During the Initial Term"

In *1290079 Ontario Inc. v. Beltsos* [2011] O.J. No. 1970 (Ont. C.A.) the tenant had sublet the premises to a sublessee, and the sublessee's insurance policy was defective due to a failure to name the landlord as an insured party. The sublessee rectified the breach and cured the default. However, the day prior to the default being cured, a slip and fall accident occurred on the premises which resulted in a lawsuit, naming the head landlord as one of the defendants.

Prior to the resolution of the lawsuit, the tenant attempted to exercise its option to renew contained in the head lease. The head lease provided that the tenant's right to renew was in effect so long as the tenant "is not during the initial Term in default under any of the provisions or covenants of this lease".

The court reaffirmed the notion that a momentary or historical breach which has been cured at the time that a tenant seeks to exercise a right to renew does not constitute grounds upon which a landlord can refuse the right. However, the slip and fall claim had yet to be resolved and was therefore classified as a "subsisting breach", which prevented the tenant from being able to benefit

from the right to renew. If the claim had been resolved at the time the option was exercised, the default would fall within the category of a "spent breach", and would not preclude the tenant from its right to renew.

"Material Default"

In the case of *1556724 Ontario Inc. v. Bogart Corp* [2011] O.J. No. 1940 (Ont. S.C.J.), the tenant's renewal right was contingent on the tenant being in good standing and having "not been in material default under the lease". Throughout the term of the lease, the tenant had committed numerous defaults; however, at the time the tenant purported to exercise the renewal option, all prior defaults had been cured. The tenant argued that because it had cured all previous defaults, that they were "spent breaches" that should not interfere with its right to renew. The court found that the tenant's previous breaches constituted "material breaches" under the terms of the lease, and therefore did not grant the tenant the right to exercise the renewal option. Despite the fact that the tenant had cured all defaults prior to exercising the renewal option, the failure to comply with the condition precedent precluded the tenant from relying on the renewal provision. The court based its decision on the facts of the case and did not provide a method for determining what type of conduct would constitute a material breach. However, it is clear that the court will scrutinize a tenant's conduct closely and will consider a wide range of actions when making a determination with respect to a default under the terms of a lease.

Conclusion

It is important to note that the above examples only represent some of the most common condition precedents utilized in renewal provisions. When negotiating the inclusion of a renewal or extension option in a commercial lease, the manner in which such a provision is drafted is of paramount importance. The exact wording and phrasing of any condition precedent in such a provision must be clear, precise and demonstrative of the intent of the parties. Landlords must keep in mind that the inclusion or exclusion of a time related caveat to a condition precedent, or a limit on the nature or extent of the condition precedent, will each have a significant impact on the tenant's ability to exercise an option to renew or extend, and will alter the manner in which a court will interpret such a provision. On the flip side, tenants should always negotiate for reasonable qualifiers on the nature of a default, such as "material", "continuing" or "at the time of exercising", and otherwise limit any pre-condition that spans the term of the lease.