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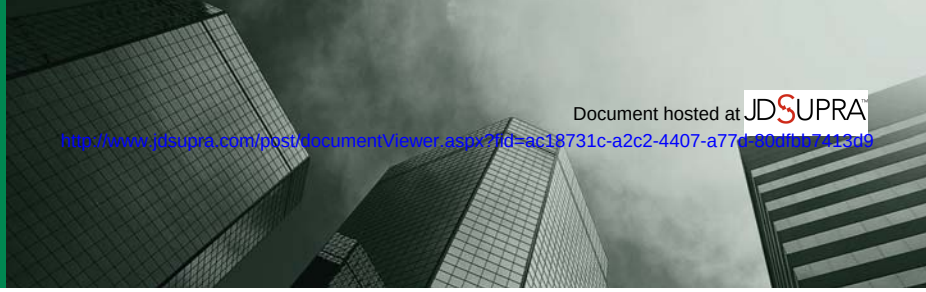

RealEstateBrief

Winter 2007/2008

In This Issue

Celia Hitch of the Toronto office continues her series on restaurant leases. In this second instalment Celia discusses particular lease issues that arise from the use of premises as a restaurant, such as how to deal with a patio and liquor licence matters.

Landlords and lenders may be surprised to learn that if their tenants or borrowers engage in certain illegal activates, the rights of the landlord and lender could be severely impacted. Lindsay Goldberg of the Vancouver office reviews how the *Controlled Drugs and Substances Act* (CDSA) allows the federal government to request that a court order the seizure and restraint of any offence-related property, pending the outcome of the offender's criminal trial and, on conviction, complete forfeiture of the property to the government.

Avoiding Heartburn: Restaurant Leases

Celia Hitch

Introduction

In the last *Real Estate Brief*, I started a three-part series on restaurant leases. Twice this year I have spoken at conferences on issues which are specific to restaurant tenants and their lease negotiations, which has given me the opportunity to focus on what makes restaurants different and how to address those differences.

I spoke to the initial and future identity of the tenant and restaurant operator, including the possibility of a franchisee operating the restaurant.

In this second article, I will discuss use issues, including issues which often show up with restaurant uses, like patios and liquor licences.

Use

Restaurants have specific issues that arise from their use, which are not generally at issue in a standard retail tenant negotiation. One of the most fundamental differences between a restaurant and a clothing store is hours of business. Few of us expect to buy clothes much past 9 o'clock at night but most of us expect sit-down restaurants to still be open at that time. Similarly, we may shop for clothes at 10 o'clock in the morning but we rarely patronize licensed sit-down restaurants in shopping centres before lunch time.

Both food court and sit-down restaurant tenants will likely want to be able to operate independent of the general operating hours for the shopping centre. Food court tenants may want to close earlier, since there is rarely much traffic in the food court past about 7:30 or 8 p.m. At the other end of the food spectrum are the food outlets which specialize in coffee and breakfast items like bagels or muffins. They often want to be open by 6 or 7 o'clock in the morning, so that they can capture as much of the morning breakfast traffic as possible. Sit-down restaurants rarely want to open at 9:30 or 10 in the morning unless they already have a well-developed breakfast trade. All of these needs will have to be considered in negotiating the lease. In turn, the landlord's need to have the shopping centre open and functioning will also have to be taken into consideration.

The restaurant's proposed use itself will also need to be considered in the context both of existing and prospective uses in the centre. A restaurant tenant will likely not be prepared to be tied to a sample menu appended to the lease for its entire lease term but, on the other hand, the landlord will want some certainty that the restaurant will be compatible with, rather than competitive with, existing and prospective users. A use clause, for instance, of "foods derived from

various Mediterranean cuisines," although potentially appealing to the demographics the landlord wants to reach, may cross over the themes of several other food sellers in the property including, for example, an Italian restaurant and a Greek restaurant. Even in the absence of any exclusive covenants protecting those uses, a prudent landlord will want to ensure that a new tenant is not cannibalizing the sales of an existing tenant.

Other Tenants' Expectations

As with many retail uses which fall outside of the standard "store" type use, there may be controls in place which prohibit a landlord from proceeding with the deal. A food anchor, for instance, may prohibit a sit-down restaurant within 300 feet of its entrance. Many anchor tenants prohibit "arcade" type uses, whether or not they sell food as well, so there needs to be clarity as to whether or not four or five pinball or arcade-type machines within a restaurant will cause a problem for the landlord. Similarly, some anchor tenant leases prohibit "nightclubs and discotheques." This wording may have had a clear meaning in the 1970s but is often difficult to interpret in the context of a 21st century shopping centre.

Some in-line retailers may also require that the landlord not lease to food uses on either side of their space. This is uncommon but not unheard of with the more expensive ladies' wear stores, as they do not want their merchandise ruined by careless hands holding ice cream cones, cups of coffee or other food items.

Even in the absence of any exclusive covenants protecting those uses, a prudent landlord will want to ensure that a new tenant is not cannibalizing the sales of an existing tenant.

Liquor Licences

Although food court and coffee outlets generally do not need a liquor licence, almost all sit-down restaurants will want to serve some sort of alcoholic beverages. Obtaining a liquor licence generally involves a sufficiently complex process that the time between signing the lease and opening the business may be longer than that for most retail uses, partly because of the delays involved in obtaining the licence. For landlords, there should be a clear understanding that the tenant will apply for a liquor licence as soon as possible and pursue its application diligently to completion. Although some tenants will "pre-open" while waiting for their licence, for a roadhouse type of tenant, for instance, opening makes little sense without a liquor licence. Although it is self-evident, the use clause should provide that the tenant will only sell liquor if it is properly licensed to do so.

Patios

Here in Canada, where winter can seem endless, patios are treasured additions to restaurants, as the first sunny day of spring will usually find the patios packed full – even if everyone has to wear a sweater!

There are certain complexities to adding patio space into the tenant's use which need to be considered up front. Is the tenant to pay rent on the patio space? Often, a landlord will not want to charge rent because the patio is an exclusive-use common area for five months of the year but, for the other seven months of the year, the landlord wants it to revert to common area so that there is no shortfall for that period. A landlord will, however, expect to see the sales from the patio included in the tenant's Gross Revenue for Percentage Rent purposes.

What other issues will a landlord want to focus on? A landlord will likely want the right to approve of the tenant's patio fixtures, to ensure that the tenant is not buying second-rate, on-sale backyard furniture and lowering the appearance of the centre. The tenant will need assurances that there will be direct access from its space to the patio and a clear understanding of who is paying for the doorway to be cut, if necessary.

The tenant will want to ensure that there are proper barricades around the patio space to ensure that it is fluid with the restaurant space and people are not just walking through it on the way to their destination. In turn, though, a landlord will want to have the usual aesthetic controls over the quality and appearance of those barricades. The landlord will want to ensure, as well, that when the snow flies, those barricades are removed and the patio furniture is stored elsewhere, so that a special summer place does not accidentally become a winter hazard.

Conclusion

Although much of a restaurant lease negotiation will resemble any other retail lease negotiation, there are specific issues, such as patios and liquor licences, which are particular to restaurants. It is important, in approaching a restaurant lease negotiation, to understand these issues so that the parties can create the solutions which are best for them in the lease document.

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Can the Activities of Your Borrowers or Tenants Lead to Seizure of Your Property?

Lindsay D. Goldberg

Introduction

Would the Canadian government ever try to seize investment property, mortgage investment security or any other valuable assets, even from law abiding taxpayers? The surprising answer is "yes."

There is a little-known provision of federal drug enforcement legislation which the government has been using that supports these actions. Even to its non-drinking, non-smoking, non-drug-using and environmentally friendly citizens. Even to those of society's best-behaved and productive contributors.

Controlled Drugs and Substances Act

How could a landlord or lender find their property tied up? First a little background on Canadian criminal drug enforcement.

The *Controlled Drugs and Substances Act* ("CDSA") is an important device in the federal government's law enforcement arsenal. At the government's request, it permits a court to order the seizure and restraint of any offence-related property pending the outcome of the offender's criminal trial and, on conviction, complete forfeiture of the property to the government. "Offence-related property" under the CDSA includes any property, within or outside Canada, that is used in any manner in connection with the commission of a designated substance offence. An obvious example is a home used as a grow-op for the production of marijuana. If the Crown establishes reasonable grounds to believe that a house has been used as a grow-op, then a judge may make a restraint order under section 14(3) of the CDSA "prohibiting any person from disposing of, or otherwise dealing with any interest in, the offence-related property specified in the order other than in such manner as may be specified in the order." This section serves to prevent the disposition of offence-related property pending a criminal trial so that, if the accused is convicted, the Crown may seek as part of the sentencing package the property's forfeiture to the government. These restraint and forfeiture provisions of the CDSA are intended by Parliament to serve as a general deterrent, make offence-related property unavailable for further criminal use and impose a very high cost to committing a criminal act.

So far, this appears to be quite reasonable. The government must arm itself with powerful tools to fight crime. Other than the criminals themselves and their lawyers, no one would complain about the government's seizure of a convict's property.

The Reach of the CDSA

The trouble is that the government does not believe that the CDSA should be limited only to participants in the alleged crime. On the contrary, the Crown says the statute empowers the government to tie up for interminable periods and ultimately confiscate property even from those not charged with any offence. In two recent cases (*Scotia Mortgage Corporation* v. *Leung*, and *Maple Trust Company* v. *Walton*) involving foreclosures of alleged grow-op homes in B.C., the Crown argued that a CDSA restraint prevents mortgage lenders from foreclosing on their security before the criminal proceedings are concluded – potentially for many years. The Crown said that it is necessary to stop the lenders' foreclosures, pending the outcome of the borrowers' criminal trials, because the mortgages themselves are liable to future CDSA forfeiture. After a borrower's conviction, the onus is on the lender to prove that they were innocent of collusion or complicity in the crimes, and that they "exercised all reasonable care to be satisfied that the property was not likely to have been used in connection with the commission of an unlawful act." The Crown could presumably make the same argument in respect of a realization of a landlord exercising remedies against a tenant.

The Crown argued that a CDSA restraint prevents mortgage lenders from foreclosing on their security before the criminal proceedings are concluded – potentially for many years.

How does a mortgage lender or a landlord prove that? How would the average person? Parliament doesn't say. And that is not the Crown's problem. Of course, the Crown never suggested that either Scotia Mortgage Corporation or Maple Trust Company participated in any way in the alleged drug cultivation. These are large Canadian lending institutions interested only in the residential mortgage business, not drug cultivation, and it is absurd to even suggest that these lenders

were complicit or participated in any alleged criminal activity.

Both the B.C. Supreme Court and Court of Appeal ruled that clearly innocent lenders should not be dragged into the middle of their borrowers' criminal disputes with the Crown and should not be delayed in their mortgage realization. At the time of writing, it is not yet known whether the Crown will appeal the B.C. rulings.

Conclusion

If a lender takes mortgage security on a B.C. home that, through no fault of its own was used as a grow-op, is it fair that their attempts to foreclose are delayed until after the criminal trial (and appeals) and they are forced to incur the legal expense of proving their innocence to protect their mortgage investment from the government? Fortunately, B.C. courts don't think so. This may be because when a mortgage investment in Canada is made, the lender is more concerned with the borrower's creditworthiness than the expense of a legal battle.

Lindsay D. Goldberg is a partner with the Litigation Group in Vancouver. Contact him at 604-691-7476 or lgoldberg@lmls.com.

News and Events

News

Annie Thuan has Joined Lang Michener's Toronto Office

We are pleased to announce that **Annie Thuan** has joined the Real Estate Law Group as an associate in Toronto. Ms. Thuan's practice is focused in the areas of environmental and aboriginal law.

Lang Michener's Real Estate Group Welcomes Senior Leasing Clerk

Lang Michener's Real Estate Group is pleased to announce that **Brenda Dunning** has joined the Toronto office as Senior Leasing Clerk. Brenda joins Lang Michener after having extensive experience working in the real estate industry, most recently for a full-service real estate management and leasing company.

Events

3rd Commercial Real Estate Leases

December 10 & 11, 2007
Toronto Hilton Hotel
Toronto, ON

Lang Michener is pleased to be sponsoring this two-day conference that will provide those involved in landlord/tenant relationships with practical information about operating cost issues, the trends in commercial lease negotiations, the latest leasing issues for franchises, and incentives and inducements for landlords and tenants. **Celia Hitch**, counsel in the Real Estate Group in Toronto, will be speaking at the conference.

RealEstateBrief

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Publication Mail Agreement Number 40007871

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