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Options to renew are commonly agreed to by landlords as part of negotiations with tenants. Usually, but not exclusively an option to renew is included in the lease. Occasionally it may be contained in a separate lease renewal agreement.

I. Drafting an Option to Renew

There are several important issues for a solicitor to consider when drafting an option to renew:

1. the conditions precedent to the exercise of the option to renew;
2. whether the option to renew extends the term or creates a new term;
3. the rent or, if the rent is not set, the formula for determining the rent on the renewal term;
4. whether the option is perpetual or limited;
5. the continuity of covenants in the lease; and  
6. the mechanism to implement the formula if the parties are unable to agree on the rent.

A. Conditions Precedent  
The conditions to the exercise of an option to renew usually encompass:  
1. a standard of performance by the tenant of the terms of the lease;  
2. the dates between which the option must be exercised;  
3. the place to which notice must be delivered; and  
4. the form of notice.

The standard of performance under the lease as a condition precedent to the exercise of an option to renew requires careful consideration by both landlord and tenant. There are many different standards that can be set, among which are:  
1. not to be in default of any condition or covenant under the lease;  
2. to have duly and regularly paid the rent and observed and performed the covenants and conditions under the lease; and  
3. to have duly and punctually paid the rent and observed and performed the covenants and conditions under the lease.¹

Each of these standards requires an increasingly more rigorous compliance with the lease. It is important in setting a standard to distinguish between two points in time when the standard is applicable:  
1. the date of exercise of the option; and  
2. the date of commencement of the new term.

In the former the right to exercise will be subject to the standard but in the second the right may be exercised but the new term not granted if the standard is not met by the date the renewal term is to commence. In effect the standards may become “conditions subsequent.”²

B. Extending the Term or Creating a New Term  
Creating a new term by a renewal can, unless dealt with by specific wording, limit or extinguish certain personal covenants and rights. This issue can have relevance in a number of areas, most particularly for covenants in respect of the condition of the premises. Where the tenant carries on an industrial activity or operates in a business that uses or creates potential contaminants it can be important to ensure that covenants to maintain and repair the premises extend to the commencement of the tenancy, particularly where there are a series of renewals and new leases.

A second area where difficulty can arise is in the inclusion (or exclusion) of tenant’s improvements in determining the rent. A new term may well, in the absence of language to the contrary, result in


² See, for example, SME Holdings Ltd. v. Cappeech Coffee Corp., 2000 BCCA 524 in which the Court concluded that a clause that made no reference to a particular time meant the date of the expiry of the existing term, not the date the option was exercised.
tenant’s improvements being taken into account where an extension of the term would likely not.\footnote{See Fire Productions Ltd. v. Lauro, 2006 BCCA 497.} Clear and explicit drafting of the renewal clause will avoid this potential difficulty, as discussed below.

C. **Perpetual Option**

A perpetual renewal does not offend the rule against perpetuities and is enforceable.\footnote{See Perpetuity Act, R.S.B.C. 1996, c. 358, s. 20(4).} Generally the courts will not find an option creates a perpetual renewal unless the language of the option leads to that result.\footnote{See Wilson v. Kerner (1912), 3 D.L.R. 11 (Ont. H.C.); R. v. St. Catherines Hydraulic Co. (1910), 43 S.C.R. 595.} However, it is prudent to include language that limits the renewal to the specific number of renewal options agreed to.

D. **Formula for the Rent**

It is usual to provide that the rent during a renewal term will be agreed to by the parties pursuant to a formula. The practical consequences of various formulas are discussed below. The main considerations for a formula for the rent are:

1. the relationship to market rent or to some other standard;
2. whether tenant’s improvements are to be included or excluded;
3. the tenant’s use, or restrictions on use, of the premises; and
4. whether rental comparisons are limited by location, use, age, size or some other factor.

A provision that the parties will agree on the rent, without a formula and without a mechanism, will be unenforceable as an “agreement to agree.” This issue is discussed below.

The inclusion of tenant’s improvements in determining rent for a renewal term can be a significant issue.\footnote{Discussed below. See Fire Productions Ltd. v. Lauro, 2006 BCCA 497.}

It should also be noted that the more restricted the formula the greater the likelihood that there will be difficulties in determining the rent. Frequently a lease will require the rent to be determined with regard to a specific type of property or use, or in a specific geographic area. While at the time of the agreement these restrictions may make sense the passage of time may make them difficult if not impossible to apply. One need only observe the changes on parts of Robson Street over the past 25 years to see how an area can change dramatically.\footnote{Robson was once called “Robsonstrasse” because of the German restaurants and delis, none of which now survive.}

E. **Continuity of Covenants**

The continuity of covenants on a renewal term can present some unhappy surprises to inattentive drafters. Some covenants in leases are not intended to carry on beyond the initial term such as:

1. rent free periods;
2. tenant’s inducement allowances; and
3. some options to renew.
It is important to consider what terms and conditions of the lease carry through into the renewal term. For example, a provision that the renewal is “on the same terms and conditions as the lease” will likely include an option to renew—in effect creating a perpetual right of renewal. This can be avoided by the addition of the words “except this right of renewal.”

**F. Mechanism for Determining Rent**

The most common mechanism for determining the rent in the absence of agreement is by arbitration, either before a panel of one or three arbitrators. However, other approaches can used such as:

1. a valuation; or
2. a “baseball arbitration.”

In developing a renewal mechanism a prudent solicitor should consult with a litigator about the practical aspects of the mechanism.

As a practical matter most renewals that are not resolved through negotiation will require each party to obtain an appraisal. This can prove to be expensive and sometimes cost the parties more than the amount in dispute.

**II. Exercising an Option to Renew**

A tenant’s decision to exercise an option to renew should be taken thoughtfully. In not all circumstances is it a good strategy. The decision to exercise, or not exercise, is irrevocable once the time limit has passed. Therefore, the first issue to consider is:

whether to exercise an option to renew?

Among the important factors for a tenant to consider are:

1. what are current market rents?
2. what is the vacancy rate and are alternate premises available?
3. what would it cost to move?
4. does the option to renew have a “floor” rent or is it market rent?
5. are the current premises suitable?
6. is the relationship with the landlord healthy?
7. do the terms of the renewal, such as the length of the term, accord with the tenant’s business plan?

These and other factors should be kept in mind before deciding to exercise an option.

**A. Exercising the Option**

Once a decision has been made to exercise an option to renew it is critical to follow precisely the process set out in the lease. This means reading the lease.

An option to renew must be exercised clearly and unequivocally in accordance with the provisions of the lease. This means that the tenant must:

1. comply with, and be in compliance with, any conditions precedent;
2. give notice of the exercise of the option within the time limited by the option;
3. deliver the notice to the place required by the option; and
4. not include any conditions or qualifications to the exercise of the option or seek to change any terms of the lease.

It is important to remember that the failure to meet these requirements will usually result in the right to renew under the option being lost as the court has no power to relieve from forfeiture for the failure to comply with the terms of an option to renew.\(^8\)

Once an option to renew is validly exercised it is binding on both the landlord and the tenant, unless the parties agree to modify the terms of the renewal.\(^9\)

1. **Conditions Precedent**

As discussed above, most modern options to renew a lease will require that the tenant have “duly and regularly” or “duly and punctually”\(^10\) (or some similar phrase) paid the rent and fulfilled its other obligations under the lease.

Whether the tenant has failed to fulfill the conditions precedent can be difficult to establish. A prudent landlord will document breaches and be careful to give appropriate notices of default. It should be remembered that there is a distinction between a default under a lease and a failure to fulfill a condition precedent. Both can arise from the same event, but the default may be waived or cured, but the failure to fulfill the condition precedent remains unless waived by the landlord.

2. **Time for Exercise**

Most options to renew will require that the exercise the option occur within a certain window of time (often 9 to 6 months before the expiration of the current term). The failure to exercise the option within the time limits is fatal,\(^11\) unless it can be shown that the landlord has waived compliance with, or is otherwise estopped from relying on, the time limits.

3. **Delivery of the Notice**

The lease will often specify that the notice is to be delivered to the landlord at a specified location and by a specific means. Courts are typically more likely to find that a notice was delivered if it was delivered within time to the landlord even if not to the address specified in the lease, particularly where the lease is not clear.\(^12\)

4. **Qualifying Provisions in the Notice**

In many cases a tenant has tried to exercise an option to renew with qualifying words such as “provided we agree on the rent,” but has discovered that the option has not been properly exercised.\(^13\)

The exercise of an option to renew is not a time to try to renegotiate the terms of a lease.

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\(^8\) See *Clark Auto Body Ltd. v. Integra Custom Collision Ltd.*, 2007 BCCA 24 reversing 2006 BCSC 1730.


\(^10\) There is a significant difference between these two standards. See *McLaughlin v. Bodnarchuk* (1957), 8 D.L.R. (2d) 596 (B.C.C.A.) and *Maclaine v. Gatty*, [1921] A.C. 376.


\(^13\) See, for example, *Tsakumis and Trigate Development Corp. v. First Class Systems Corp.*, 2001 BCSC 322; *Royal City Shopping Centre Ltd. v. Canadian Direct Insurance Inc.*, 2005 BCSC 1597.
B. Determining the Rent for the Renewal Term

An effective renewal provision provides both a formula for the rent and a mechanism for determining the rent in the absence of an agreement. The absence of a formula for the rent will likely mean that an option to renew is not be enforceable. However if the option lacks a mechanism to determine the rent the court will usually supply it. The three methods generally available are:

1. negotiation;
2. arbitration; or
3. an action.

There are two approaches to a formula to determine the rent on a renewal:

1. an “objective” rent; or
2. a “subjective” rent.

In addition there is often an issue as to whether tenant’s improvements are to be included in the rent for the renewal term. This will largely hinge on the language used in the lease and is sometimes subsumed in the question of whether the rent is “objective” or “subjective.”

1. An Objective Rent

An objective rent will be related to “market” rent in some formulation. The words qualifying “market rent” can be extremely important. Market rent formulas will necessarily refer to comparable properties as a basis for comparison and determining the market rent. Often words of qualification will refer to:

1. the location of the comparables to be considered;
2. the use of the premises for the comparables; or
3. the size of the comparables.

As a practical matter the more restrictive the qualifications are the more difficult it may be for an appraiser to obtain suitable market data. At the time of drafting such qualifications they may seem appropriate but areas change over time and a use that was once common in an area may largely disappear. Second, unusual uses or configurations may also present significant difficulties if the qualifications are too specific.

2. A Subjective Rent

A subjective rent will take into account the specific circumstances of the particular landlord and the particular tenant. This will arise where the rent is to be a “fair” rent or a “reasonable” rent, without reference to “market” or other properties or types of properties. This type of formula is extremely rare (and best avoided) in Canada.

3. “As is” vs. “As Was”

This issue arises frequently: are tenant’s improvements to be taken into account in determining the rent for the renewal term? The answer is not always so easily found as it will largely hinge on the

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construction of the provisions of the lease, including whether such improvements become the property of the landlord. As a result the issue of exclusion or inclusion of tenant’s improvements in determining the rent on renewal should be specifically stated. The difference can be substantial, particularly where the tenant has made significant improvements to the premises.18

4. Net Effective Rent

In looking at comparables it is extremely important to ensure that the rents are set out on a consistent basis. Today there are many charges built into leases that change the “net effective rent.” This is a phrase that is an attempt to provide a consistent approach to comparing rents. The net effective rent will take into account:

1. gross up provisions;
2. management fees;
3. administration fees; and
4. other charges that are not direct cost recovery items.

A “gross up” provision adds the tenant’s proportionate share of the common areas (lobbies, hallways, elevators shafts, loading docks, etc.) to the tenant’s rentable area. In effect it increases the tenant’s rent by the tenant’s proportionate share.

Management fees and administration fees are charged on various expenses and sometimes on the base rent as well. Effectively the base rent is increased by the amount of the fee.

Landlords may include other charges (the inventiveness of landlords in creating such charges is probably inexhaustible) which are not directly related to the recovery of costs. Each such charge is effectively an increase in the base rent.

C. Dispute Resolution: Arbitration and Other Processes

The first thing to be considered is the cost/benefit of invoking the dispute resolution proceeding. As mentioned above, most processes require the parties to obtain an appraisal so the first step should be to estimate the costs of the process and compare the costs with the difference in position of the parties.

Arbitration is a common way to determine the rent for a renewal term, although most are settled before hearing, in part because of the expense and secondly because the parties will have exchanged appraisals that, often for the first time, provide a foundation for their negotiating position.

The cost of arbitration can be high and for most commercial properties not economic.

There are various other processes that can be used to set the rent such as:

1. valuation;
2. mediation; and
3. a “baseball” arbitration.

Each process has advantages and disadvantages.

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18 Restaurants are a good example. See Fire Productions Ltd. v. Lauro, 2006 BCCA 497 where “fair market rent” was found to include the value of the tenant’s improvements.
1. Valuation

Valuation is the determination of a point in dispute by a third party (a “valuer”) who will rely on his or her own skill and judgment. The most common application is the determination of the rent on a renewal, but the process could be applied to almost any dispute.

There are some advantages and disadvantages to the process:

1. the cost is usually lower than other processes;
2. there is no hearing or submissions, although the parties may provide information to the valuer;
3. the decision is binding and there is no appeal, an unhappy party only has a remedy in negligence against the valuer; and
4. the decision may be enforced by an action for specific performance (but not under the Commercial Arbitration Act, R.S.B.C. 1996, c. 55).

The success of a valuation will depend in large measure on the appointment of an appropriate person as a valuer. Both parties must have confidence in the appointment and counsel involved in such a process should carry out some “due diligence” before agreeing to the appointment.

2. Mediation

Mediation is a form of “assisted negotiation” with two significant advantages over direct negotiation which arise from the participation of a neutral observer:

1. who may be, and usually is, able to offer objective insights into the issues arising in the dispute to allow the parties to better understand their case and the case of the other party; and
2. who can encourage the parties to explore a settlement that might include terms, agreements or concessions that would not be available if litigated.

Mediation can be a useful process to preserve an ongoing relationship, but if unsuccessful will add an extra level of costs to resolving the rent.

3. “Baseball” Arbitration

In this process the parties engage an arbitrator who is presented with each party’s position on the rent and supporting evidence. The arbitrator is required to select one or other of the figures. The theory behind this process is that it forces the parties to make reasonable proposals because there is no possibility of “splitting the difference.”

D. Appraisals

An appraisal is essential to the determination of rent for a renewal term in an arbitration or a court proceeding.

In commissioning an appraisal, counsel should set out the terms of reference for the appraisal in writing. These should reflect the language of the lease and provide any assumptions the appraiser is to make. It is prudent, where there may be doubt about whether an assumption is correct, to request alternate opinions based on the different assumptions. This would arise, for example, where there is doubt whether tenant’s improvements should be included or not.
Counsel should be careful not to, and not to appear to, direct the appraiser to a particular conclusion. This can lead to the appraisal being disregarded.\footnote{See \textit{Summit Staging Ltd. v. 596373 B.C. Ltd.}, 2008 BCSC 198 at ¶ 91.}

However it is appropriate for counsel to “test” the analysis of an appraiser and to ensure that the conclusions are supported by the analysis. Frequently appraisers make “adjustments” to comparables without providing a clear explanation. As this is frequently an area for cross-examination counsel should insist that the appraiser set out the basis for adjustments.

Once appraisals are exchanged as part of an arbitration the dispute is frequently settled because the difference between the parties has crystallized. This difference can then be compared to the cost of completing the arbitration and a business decision made on the risks of proceeding as compared to a settlement.