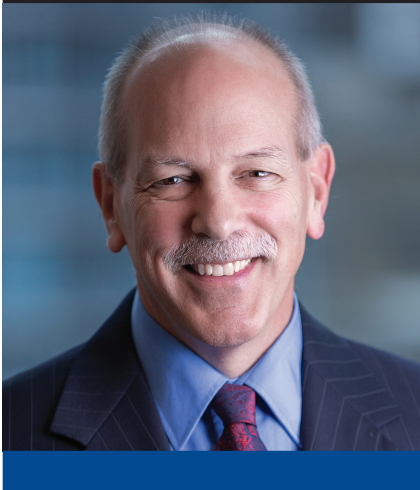


# RENT REVIEW CLAUSES: MARKET-BASED OR NOT?

BY JOHN SHEVCHUK

BARRISTER & SOLICITOR, C.ARB, AACI(HON), RI



**“TO DECIDE IF RENT IS BASED ON THE MARKET OR OTHER CRITERIA, PRINCIPLES OF CONTRACT MUST BE APPLIED.”**

In a rent review under a lease, the lease must be read to determine the basis upon which the landlord and the tenant have agreed rent will be reset. Is the rent to be based on the market or upon other criteria established by the parties? To decide the question, principles of contract interpretation must be applied.

### General interpretation principles

The interpretation principles applicable to a lease were recently confirmed in *Park Royal Shopping Center Holdings Ltd. v. Gap (Canada) Inc.*, 2017 BCSC 1257 [*Park Royal*]. At paragraphs 51 and 52, the court wrote the following:

[51] As noted in *Athwal v. Black Top Cabs Ltd.*, 2012 BCCA 107:

[42] The contractual intent of the parties to a written contract is objectively determined by construing the plain and ordinary meaning of the words of the contract in the context of the contract as a whole and the surrounding circumstances (or factual matrix) that existed at the time the contract was made, unless to do (*sic*) would result in an absurdity.

[52] The “interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract:” *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 at para. 57.

In *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 [*Sattva*], Rothstein J. wrote at paragraph 47 that “... Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning ...” At paragraph 48, Rothstein J. explained further:

48 The meaning of words is often derived from a number of contextual factors, including the purpose of the agreement and the nature of the relationship created by the agreement ... As stated by Lord Hoffmann in *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, [1998] 1 All E.R. 98 (H.L.):

The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean ...

At paragraph 57, the role of surrounding circumstances was described: “While the surrounding circumstances will

be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of the agreement ... The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract." Evidence that qualifies under "surrounding circumstances" was discussed at paragraph 58, part of which is set out below:

58 The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to case. It does, however, have its limits. It should consist only of objective evidence of the background facts at the time of the execution of the contract ... that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting ...

### Application of interpretation principles to leases

Given the current state of the law regarding interpretation of contracts, which includes leases, how will a court determine if rent is to be reset having regard to the market or on some other basis? Although the following cases pre-date *Sattva* and *Park Royal*, perhaps they can provide some insight on the way forward.

In *Fire Productions Ltd. v. Lauro*, 2006 BCCA 497, Mr. Justice Lowry held at paragraph 9 that "fair" in "fair market value" does not mean that rent is to be calculated on some basis other than what the market would attract. He held that the parties did not agree to "fair rent," but to fair *market* rent. "Fair" adds nothing to the meaning of market rent except that the market is to be considered a consistent market unaffected by significant transient fluctuations that may be evident at the time of renewal. In coming to this

conclusion, the learned justice relied upon the Supreme Court of Canada's interpretation of the word "fair" in considering the fair market value of shares in *Untermeyer v. British Columbia (Attorney General)* (1928), [1929] S.C.R. 84 at 319.

In *NRI Manufacturing Inc. v. Gross*, 1998 CarswellOnt 2741 (Ont. Gen. Div.) [*NRI Manufacturing*],<sup>1</sup> the court considered the following clause in a lease renewal dispute:

#### Section 19.2 Rent for Initial Renewal Term

The Basic Rent payable for each year of the Initial Renewal Term will be the fair market rental value of the Initial Renewal Premises as at December 31, 1998.

For the purposes of this Section 19.2, "fair market rental value" of the Initial Renewal Premises

will be as agreed by the parties or as determined by arbitration as provided herein, based on all relevant facts and circumstances ...

The tenant argued that the plain language of the agreement, both in law and in accordance with industry standards, required that an objective market value approach be adopted. The landlord contended that giving effect to the tenant's position would make superfluous the phrase "... based on all relevant facts and circumstances ..." contained in Article 19.2. The court quoted from *Yonge-Eglinton Building Ltd. v. Toronto Transit Commission* (1997), 97 O.A.C. 205 (Ont. Div. Ct.) where "... to fix a fair and proper sum to be paid as yearly rent of the said demised parcels of land..." was the disputed phrase:

A large number of cases were referred to by counsel for each party.



The wording of the lease in each case determined whether the approach should be subjective or objective. The difference being whether it is to be the value to the parties or the market value.

In *Revenue Properties Co. v. Victoria University* ..., the words were “fair market value” and it was determined that an objective approach should be taken. On the other hand, in *Canada (Attorney General) v. Lynnwood Industries Estates Ltd.* ... where provision was made that, if there was no mutual agreement the “rent was to be arbitrated,” the subjective approach was taken. It would appear that wherever the words used refer to “market value,” “market rent” or “appraised value,” the objective approach is to be taken. For the words that merely refer to “rent” or “worth,” the subjective approach is to be taken ...

The court in *NRI Manufacturing* also referred to *Halsbury’s Laws of England: 8 Halsbury’s Laws of England* ... speaks to the meaning of “rental value:”

**273. Meaning of “rental value.”** Rent review clauses necessarily require the valuer to ascertain rental value, but may qualify this expression with words, such as ‘market,’ ‘open market,’ ‘rack,’ ‘fair,’ ‘reasonable,’ ‘best’ or ‘highest,’ but none of these qualifications seems to make any difference. It has been said that there is no difference between a market rent and an open market rent; that, in the expression ‘market rack rental value,’ the word ‘market’ adds nothing to ‘rack’ or vice versa, and that, in the commonly used formula ‘the highest rent at which the premises might reasonably be expected to be let,’ the word ‘highest’ adds only

emphasis because the rent at which premises might reasonably be expected to be let in the open market by a willing landlord is the highest rent available... A fair and/or reasonable rent is the same as market rent in that it requires an objective assessment of the rent which could be obtained without taking into account consideration personal to the actual parties. The concept of a reasonable rent differs from that of a rent which it would be reasonable for the tenant to pay, which will let in considerations personal to the actual parties such as whether the tenant should or would agree to pay rent for his own improvements.

In *NRI Manufacturing*, “fair market value” was the standard set by the lease and the court held that this imposes an objective approach, i.e., based on market.

In *Autotrol Technology (Canada) Ltd. v. Triple D Holdings Ltd.*, 2000 ABCA 195 (Alta. C.A.) on July 31, 1997, Autotrol exercised an option to renew an existing lease for a further five years commencing January 1, 1998. The renewal clause provided that “[a] new rent will be negotiated and, failing agreement, it will be determined under the usual method of arbitration.” No criteria were provided for determining the rental rate or date on which it was to be determined. The arbitrator held, and the parties agreed, that the rate to be determined was an objective one – the “net market rate” – rather than a “reasonable rate,” based on subjective considerations unique to the parties and their relationship. However, the appropriate date for valuation was disputed – was it July 31, 1997 or January 1, 1998? Rents had trended upwards from July 1997. The arbitrator held that the valuation date was the commencement of the new lease on January 1, 1998. The Alberta Court of Appeal agreed:

15 We do not interpret the arbitrator’s reasons as simply

selecting the actual market rate at January 1, 1998 as the appropriate rate. Rather, he assessed what reasonable parties, informed of all the relevant considerations in mid-1997, including the prevailing trend to higher rates, would have accepted at that time as a reasonable market rate to be effective as of January 1, 1998. In light of the upward movement in commercial rents in early 1997, and the probability the trend would continue, he found that it would not have been unreasonable to forecast an increase of \$2.00/s.f. between July, 1997 and January 1, 1998 ... He accepted the appraisers’ opinions of the actual rate on January 1, 1998 as the best evidence of what reasonable parties in the positions of [*the parties*] would have anticipated as the market rate on January 1, 1998.

*Autotrol* provides an example of how surrounding circumstances can affect the interpretation of a contract.

### Closing

As noted at the beginning of this article, interpretation of a lease provision involves scrutiny of the specific provision in the context of the whole lease and of surrounding circumstances. Interpretation of a lease is a legal exercise. Consequently, it is prudent for an appraiser to seek specific instruction from legal counsel as to the meaning to be given to the rent review provisions and to incorporate that instruction into the appraisal report.

### End note

<sup>1</sup> Affirmed 1999 CarswellOnt 2523 (Ont. C.A.)

*This article is provided for the purposes of generating discussion and to make practitioners aware of certain challenges presented in the law. It is not to be taken as legal advice. Any questions relating to the matters discussed herein should be put to qualified legal and appraisal practitioners.*