

Navigating franchising leasing agreements

With franchisors and franchisees involved, lease agreements can get fairly complicated. In many situations, it's not immediately obvious where obligations lie, or whether a clause will be harmful or helpful. All of the parties involved need a clear understanding of leasing law to ensure everyone benefits from the tenancy arrangement.



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1 You are the landlord of a shopping plaza. A franchisor has entered into a lease with you for certain premises, as head tenant. The franchisor, as tenant, has the right to sublease the premises to its franchisee without the prior written consent of the landlord. Since there is no privity of contract between the landlord and the franchisee, do you as landlord have any obligations to the franchisee, as subtenant?

- (a) Yes
- (b) No

2 You are a franchisor in Ontario and, as part of your franchise system, you are the direct tenant under a lease, and you sublease such premises to a franchisee. As part of your disclosure obligations, what lease documents should you disclose to your franchisee?

- (a) Only the sublease
- (b) Both the sublease and the head lease
- (c) No disclosure is required

3 You are the head tenant franchisor of a lease, and you have an arrangement with the head landlord and the subtenant franchisee, that the head landlord will deal directly with the subtenant franchisee for day-to-day matters, including the payment of rent (i.e. the subtenant franchisee pays rent directly to the landlord). Will this arrangement release the head tenant franchisor from all of its obligations under the lease?

- (a) Yes
- (b) No

4 Tenants, especially retail tenants, normally prefer to have a very broad use clause in their leases, as it leaves them a lot of flexibility to change their business and product offerings throughout the term of the lease. Does having an overly-broad use clause in a lease benefit a franchisor?

- (a) Always
- (b) Not necessarily

1 (a) Yes. Notwithstanding the fact there is no privity of contract between a landlord and a subtenant, a landlord may still be found to owe a duty of care to a franchisee subtenant. In such cases where a duty of care is found to be owed by a landlord to a subtenant, the subtenant may enforce its rights directly against the landlord despite the fact the franchisor head tenant does not support the subtenant in its action against the landlord. One such case where a duty of care was found to exist from a landlord to a subtenant is *Country Style Food Services Inc. v. 1304271 Ontario Ltd.* In this case, the landlord unilaterally reconfigured the shopping centre without notice to the subtenant. This reconfiguration resulted in major changes to the traffic flow in the shopping centre and access for patrons of the franchisee subtenant's business, including significant alterations to the drive-thru of the premises, which accounted for a significant portion of the subtenant's business. The franchisee subtenant argued it had agreed to take the premises based on the site plan that was attached to the lease as a schedule, and that the landlord's actions amounted to unilateral changes to the lease. The franchisee subtenant was able to successfully argue the landlord owed it a duty of care, and that the landlord's actions caused a significant decline in the franchisee subtenant's business.

2 (b) Both the sublease and the head lease. In Ontario, both the sublease and the head lease, along with all other related leasing documentation, must be disclosed to the franchisee. Currently, there are five provinces (Alberta, Manitoba, Ontario, New Brunswick, and Prince Edward Island) that have legislation that specifically deals with the franchising relationship. Generally, in these provinces, if a franchise system is set up so that the franchisee's rights and obligations are subject to a head lease, then the franchisor must provide a copy of the head lease as well as the sublease as part of the disclosure required. For example, in Ontario, the Arthur Wishart Act (Franchise Disclosure) provides that the remedy of rescission may be available to a franchisee in circumstances where the franchisor fails to meet certain disclosure requirements. If a franchisee fails to provide the disclosure documents within the time period specifically set out in the Arthur Wishart Act (Franchise Disclosure), then such franchisee may rescind the franchise agreement within 60 days of receiving the disclosure documents. If a franchisee is never provided with the disclosure documents or where the disclosure is considered to be so deficient as to amount to no disclosure at all, then a franchisee may rescind the franchise agreement up to two years after entering into the franchise agreement.

3 (b) No. Notwithstanding the fact the subtenant is the occupant of the premises, and has taken on the responsibility to perform the day-to-day obligations under the lease (such as paying the rent, opening for business, making repairs to the premises, etc.), the franchisor head tenant is not released from the tenant's obligations under the lease and remains fully liable for all defaults under the lease, including defaults that arise due to the acts and omissions of the franchisee subtenant. A large number of landlords and franchisor head tenants prefer to have the franchisee subtenant pay rent directly to the landlord as it is more convenient to do so. However, a franchisor head tenant should be careful when entering into such arrangements, as it is normally not aware of the daily activities going on at the premises. A head tenant must always be mindful of any arrears that may be owing by the franchisee subtenant, as well as the state of repair (or disrepair) of a premises, as it would not want to encounter a situation where a franchisee subtenant has executed a "midnight run" and the franchisor head tenant is left with all of the obligations including paying all of the rent owing as well as all repair obligations with respect to the premises.

4 (b) Not necessarily. On the one hand, a broad use clause allows a franchisor to develop new businesses and product offerings, and keep up with the ever-changing tastes of fickle consumers. For example, successful established franchisors such as Tim Hortons and McDonald's continually seek out new product offerings and opportunities to grow their businesses. Also, new franchisors may want to have the flexibility to quickly change their product offerings in order to succeed. However, an overly-broad use clause may not always benefit the franchisor, especially in cases where the franchisee is the direct tenant under the lease. There are numerous cases where franchisees go beyond the strict stipulations of the franchise agreement and offer products and services that are not within the franchise agreement in order to increase revenues. In cases where the use clause is very narrow and the franchisee is trying to change its product offerings, the landlord (or its property manager) may discover such changes prior to the franchisor discovering such activity. In cases where the use clause is overly broad, the franchisee may have more incentive to breach the franchise agreement by introducing new products and services that are not part of the franchise system.

YOUR RANKING?

- **One or less correct:** *might be time to brush up*
- **Two correct:** *not bad, but some further work needed*
- **Three correct:** *very well done, but not perfect*
- **Four correct:** *excellent*

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