

ICSC 2018 Law Conference

**THE FRANCHISE TRIANGLE:
WHAT FRANCHISORS, FRANCHISEES & LANDLORDS
WANT IN A LEASE**

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The Franchise Triangle: What Franchisors, Franchisees & Landlords Want in a Lease¹

I. INTRODUCTION

Franchising is a significant and growing part of the Canadian economy. In this environment, commercial real estate and leasing lawyers often find themselves preparing and negotiating lease documentation which involves a franchised business. The aim of this paper is to review the real estate concerns of franchisors, franchisees and property owners, and offer various alternatives for structuring their legal relationship.

In a franchise agreement, the “franchisor” is the party that owns the franchise rights to grant or sell the franchise to the “franchisee”, the party to whom the franchise rights have been granted.

Once a site has been selected, the first critical question is “**who owns the property?**” In a franchise arrangement, the location of the property whereby the franchised business operates is crucial to the success (or failure) of the business. Next the parties must determine “**who will be the tenant?**” under the lease and then the real estate aspects of the franchise arrangement must be documented by way of a lease, license agreement, sublease, tri-party agreement, or some combination of these legal documents.

As will be discussed later in this paper, the most common type of lease model is the franchisor as tenant and franchisee as subtenant. Generally, landlords prefer the franchisor as the tenant who then subleases the premises to the franchisee. In this model, landlords keep privity of the estate and contract with the franchisor, who, in most instances, are in a better financial position to have recourse against if any issues arise. Of note, while similar, as to Quebec, there is no privity of estate as such that exists. While tied to real property, the relationship between tenant and landlord is one of contract solely and remains of a personal nature, as between tenant and landlord. Franchisees also prefer the sublease model because of the franchisor’s bargaining power with the owner of the premises. Lastly, franchisors favour this model because assuming the premises is in a desirable location, the franchisor can renew the head lease, retain possession of the property and switch the franchisee. While the duty to act in good faith and reasonably in all contractual relationships has since the Supreme Court decision of *Bhasin v. Hrynew*, become a prevalent consideration under common law, in Quebec this concept has existed for some time and is ever present and notably in the context of franchise agreements and related agreements. In Quebec a franchise agreement are commonly viewed as an adhesion contract where abusive terms may not be enforceable.

II. WHO OWNS THE PROPERTY?

Site selection is an important matter in determining where the franchise will operate its business, especially if the success of the franchise depends on the customers visiting the location. Typically, the franchisor is more experienced than the franchisee in choosing a location suitable for business. Important considerations for franchisors and franchisees to consider include density of the population in that area, the buying habits and average income of that population, the traffic patterns and availability of parking facilities in the immediate vicinity, any applicable zoning laws and by-laws, and future development plans for the area. Regardless of which party is responsible for site selection, the other party should ensure that it has the right to approve the location. However, in the absence of agreement between the parties, each party should have the option to terminate the franchise agreement and upon such termination, any deposits should be returned and both parties released by the other of any further liability under the franchise agreement.

¹ This paper is an update of the papers authored by Christina Kobi entitled “The Franchise Triangle: What Franchisors, Franchisees & Landlords Want in a Lease” and Sheldon L. Disenhouse & Julie M. Robbins entitled “Leasing Aspects of the Franchise Relationship”

Control of the real estate can be fundamental to the success of a franchise system. How the parties structure their relationship (and the various options available to them) will depend on who owns the premises where the franchised business will be operated. Obviously there are three possible scenarios: the franchisor, the franchisee, or a third party landlord could own the property.

a. Franchisor as Owner

If the franchisor owns the premises, it will usually enter into a lease with the franchisee which allows the franchisor to retain control over the real estate, subject to the relevant landlord and tenant legislation². Once a landlord-tenant relationship has been created, it gives rise to a number of remedies available to the franchisor, as landlord, depending upon the particular breach by the franchisee, including:

- if the franchisor wishes to keep the lease in existence, it has several options. The two most commonly pursued remedies are to (i) sue for arrears of rent (including accelerated and additional rent) and (ii) exercise the right of distress against the franchisee's goods and chattels for non-payment of rent;
- the right to re-enter and re-let the premises as agent of the franchisee and hold the franchisee liable for any deficiency;
- the right to terminate the lease and claim damages caused by reason of the franchisee's defaults and the forfeiture of its lease;
- upon termination of the lease, the landlord has a right to sue for all payments of base rent, additional rent and other sums and charges in arrears or accruing due over what would have been the unexpired term of the lease.

It is also important to note that the landlord-tenant relationship makes certain tenant protections available to the franchisee. For instance, franchisee/tenant may apply to a court for relief from forfeiture to have the court (i) restrain the landlord/franchisor from exercising its right to re-enter and take possession of the premises or (ii) re-instate a terminated lease.³

In Quebec, the right to terminate a lease or a sublease can only occur where such non-performance causes what is termed as a serious injury or is of a material nature, such that termination cannot occur if there is a default of a minor nature. The right to re-enter and relet will only occur upon termination, which will typically be pursuant to a court order. However, a common practice in Quebec lease forms, is to provide for so-called *IPSO FACTO* termination rights in favour of the Landlord, where termination and the related rights to relet and move to obtain occupancy without court intervention, but upon notice, are often seen. As the defaults leading to these types of self-help

² This paper refers to the commercial landlord and tenant legislation of Ontario, being the *Commercial Tenancies Act*, R.S.O. 1990, c.L.7 (the "CTA"). The commercial landlord and tenant legislation of the other common law provinces is similar to the CTA. Williams & Rhodes, *Canadian Law of Landlord and Tenant*, Sixth Edition (Toronto: Carswell 1988) will assist anyone investigating the differences between the provincial statutes. Unlike many common law jurisdictions, Quebec does not have a separate landlord/tenant statute. Commercial landlord and tenant rules are found in the *Civil Code of Quebec*. Such rules are typically not of public order, except for terms as to rights of assignment and sublease and as to lease registration. Generally the landlord and tenant rules in the *Civil Code of Quebec* are less detailed than in common law jurisdictions.

³ Pursuant to Section 20(1) of the CTA a tenant can apply to court for relief from forfeiture within a reasonable period of time after the forfeiture. Often the courts are willing to grant relief from forfeiture to a first-time applicant if it pays any arrears into court or tenders them to the landlord.

remedies remain, subject to interpretation, landlords are often times reluctant to exercise their rights for fear of claims by tenants in damages.

In lieu of a lease, the franchisor could simply grant the franchisee a license to use the premises by way of a license agreement or occupancy agreement. As a licensee, the franchisee would not have any of the usual tenant rights and protections and the franchisor would not have to comply with the notice provisions or any other restrictions imposed by landlord-tenant legislation, but the franchisor would also lose any remedies unique to a landlord (e.g., distress).

If the parties decide to enter into a lease, from the franchisor's perspective it is imperative that the franchise agreement and the lease both contain cross-default clauses to avoid an anomalous situation where the franchise agreement is terminated following a default thereunder, but the franchisee still has a right to occupy and operate from the premises under the lease. As further protection, the lease should restrict the permitted use to the franchised business described in the franchise agreement and the trade name to the franchised name. This use restriction should eliminate the possibility of an assignment (by the franchisee) to a new person or entity who has not been approved by the franchisor as a franchisee.

b. Franchisee as Owner

If the franchisee owns the premises, there are three ways for the franchisor to gain control over the premises:

1. the franchisor could purchase the premises from the franchisee and then lease the premises back to the franchisee, in which case the considerations discussed in Section II.a. above would apply;
2. if the franchisee is unwilling to sell the premises, the franchisor could lease the premises from the franchisee and then sublease the premises back to the franchisee during the term of the franchise agreement. This would leave the franchisor in a position comparable to one where it had leased the premises from a third-party owner and then subleased to the franchisee, in which case the considerations discussed in Section IV.2. of this paper would apply;
3. the franchisee could give the franchisor an option to lease or an option to purchase the premises when the franchise ends, which would allow the premises to be run as a corporate-owned store or re-franchised. To facilitate this arrangement, the "lease option"⁴ or "purchase option" agreement should contain the following provisions:
 - recitals should stipulate that the parties have entered into a franchise agreement which was conditional upon the franchisee, as lessor, granting to the franchisor, as lessee, an option to lease in certain circumstances;
 - the option to lease (or option to purchase) should be exercisable upon the expiration or earlier termination of the franchise agreement;
 - the option should be exercisable by notice in writing within a specified period of time after termination or expiration;
 - if the option is exercised, the parties covenant and agree to enter into a new lease;
 - ideally the lease form will be negotiated before the time of execution of the lease option agreement and attached as a schedule;

⁴ For a sample form of Franchisor Lease Option Agreement (Franchisee Owned Premises) see *infra* note 13 at pp.10-32 to 34.

- presumably the option will become null and void at once a specified amount of time has elapsed; and
- the option agreement should address rights of either party to assign the agreement.

Since the latter two scenarios are triggered when the franchisee arrangement ends, the relationship may have soured sufficiently to jeopardize any continuing landlord-tenant relationship.

c. Third Party as Owner

The most common scenario involves a third party who owns the premises. In these circumstances, the following four (4) options are available to the franchisor and franchisee:

1. Franchisor as tenant / Franchisee as assignee;
2. Franchisor as tenant / Franchisee as subtenant (most common);
3. Franchisor as tenant / Franchisee as licensee;
4. Franchisee as tenant.

The most common scenario involves the third party owner leasing the premises to a franchisor who in turn subleases the premises to the franchisee. Typically the determination of who will be tenant will depend on the relative bargaining strengths of the franchisor, franchisee and owner, as well as the considerations discussed below in Section III.

III. WHO WILL BE THE TENANT?

A. FRANCHISOR AS TENANT

In this scenario, the franchisor enters into a direct lease with the third party owner.

(a) ***Franchisor's Perspective:***

Advantages to Franchisor being a Tenant

- Being the tenant under a direct lease with the owner (and thereby establishing privity of contract and privity of estate with the owner), would maximize the franchisor's control over the premises. Control over the real estate is especially important where a good location would generate substantial goodwill and profits regardless of who operates the business in the premises. In these circumstances, the franchisor must have the ability to take back the store from a bad operator to run it corporately or re-franchise it.
- Generally speaking, the franchisor's size, experience and financial strength should give it greater bargaining power which should in turn put the franchisor in a better position than a franchisee to negotiate favourable lease terms with the owner.
- So long as the franchisor retains control over the premises, in theory it will be in a position to transfer its leasehold interest (via assignment or sublease) to another franchisee (provided the lease does not restrict such transfers) seamlessly without public awareness and insodoing, preserve any goodwill associated with those premises.
- Upon subleasing the premises to the franchisee, a landlord-tenant relationship is created between the franchisor and franchisee and several landlord-type remedies become available to the franchisor upon a default by the franchisee, as more particularly described in Section II.a. of this paper.
- Physical re-possession of the premises makes it difficult for the franchisee to compete with other franchisees operating in the franchise system.

- It facilitates enforcement of the non-competition covenant in the franchise agreement because the franchisee will lose control over the premises (subject to franchisee's right to apply for relief from forfeiture) by virtue of a cross-default clause which immediately triggers a default under the lease whenever there is a default under the franchise agreement.

Disadvantages of Franchisor being Tenant

- The lease has to be disclosed in the franchisor's financial statements as a contingent liability which will affect the franchisor's balance sheets and financial statements. Bearing in mind this contingent liability, the franchisor should avoid being the tenant at an unproven location.
- The franchisor is exposed to liability if the franchisee violates the head lease provisions.
- If the franchisee breaches the head lease, the franchisor may be forced to occupy and operate the site until it can be refranchised.
- As previously mentioned, if the franchisor (as tenant) elects to sublease to the franchisee, a landlord/tenant relationship between the franchisor and franchisee gives rise to certain statutory protections available to the franchisee (e.g. right to apply for relief from forfeiture) and the franchisor must comply with various statutory requirements before enforcing the terms of the sublease.

In each case, the franchisor must balance its risk exposure against its need to control the premises. Often the advantages of controlling the location outweighs the franchisor's contingent liability concerns, especially in circumstances where the franchisor is responsible for delivering a "turn-key" location. In certain circumstances to avoid any such risk of liability, certain franchisors provide for the head lease to be signed by a franchisor shell entity. However, in the case of *Tesolina et al v. 153872 Canada Inc. (Mikes) et al [2002] RDI 158*, the Court of Quebec, held that as the Franchisor was in fact acting for and on behalf of the shell entity party to the lease, the franchisor was nonetheless held liable under the lease.

(b) *Franchisee's Perspective*

While the franchisee might prefer to have a direct relationship with the owner and more control over the premises (which would be the case if the franchisee was the tenant), there are some advantages to having the franchisor assume the role of tenant. Most importantly, a franchisor with a superior covenant should be in a better position than the franchisee to bargain for concessions and favourable lease terms with the owner, such as lower rents, renewal/extension options and exclusivity rights. An example as to the exercise of this renewal right in Quebec, is *9103-1658 Quebec Inc. v Café Vienne Canada Inc.* JE 2014-459. In this case, the franchisee indicated its intent to have the sublease and the underlying head lease renewed. The head lease provided for a renewal, subject to the parties agreeing upon a rental rate. Franchisor was charged by the franchise to carry out the negotiations. However, the delay to settle upon the rent under the lease lapsed without agreement whereby the landlord advised the franchisor of its intention to terminate the lease at the end of the initial term. While the Court does note the negotiations and subtenants refusal to accept landlord's proposal, it finds that the franchisor was negligent in the manner it conducted its negotiations and providing notice to franchisee and was held liable for franchisee's damages further to the termination of the lease, sublease and franchise agreement. In most cases, the benefits of favourable clauses would extend to the franchisee in the case of an assignment or sublease. As well, contingent liability under the head lease should motivate the franchisor to support the franchisee's business at that location.

(c) *Owner's Perspective*

Generally speaking, owners prefer to enter into a direct lease with the franchisor who usually has more experience, financial strength and stability than the franchisee, which should minimize the risk of a

default under the lease. As well, the franchisor's stronger covenant could improve the appeal of the shopping centre as a financing vehicle to lenders and it may attract other tenants to the centre.

It is, however, worth noting some problems that could arise when the franchisor sublets the premises to a franchisee. As a party to only the lease and not the franchise agreement, the owner/landlord does not have the same degree of control over the franchisee's operations as it would normally have over a tenant. Without privity of contract or estate with the franchisee/subtenant, the landlord cannot enforce the provisions of the head lease directly against the franchisee and the landlord's day-to-day operation of the centre could be hindered if it is forced to look first to the franchisor (who may not be readily available or accessible) to enforce the terms of the head lease even though it has daily contact with the occupant/franchisee. As well, a dispute between the franchisor and franchisee could adversely affect the premises and the rest of the centre because the owner does not have as much control over the franchisee as it would have if it leased directly to the franchisee.

In Quebec, while the general principle of privity of contract remains, the *Civil Code of Quebec*, provides specific exceptions, whereby a franchisee sublessee may be bound to the landlord for any rent amounts owing to the franchisor tenant, where a franchisee subtenant default under a sublease causes serious injury to the landlord, the landlord may obtain termination of the sublease and finally where the landlord fails to perform its obligations, the franchisee subtenant may exercise the rights and remedies of the tenant.

These perils can be avoided by requiring that both the franchisor and franchisee bind themselves contractually to the owner by way of a tri-party sublease⁵ or a three-party consent agreement. The tri-party agreement should, *inter alia*, ensure that the franchisee (as subtenant) waives any and all statutory rights available to it under the *CTA*⁶, and, where applicable the *Civil Code of Quebec*.

B. FRANCHISEE AS TENANT

In this scenario, the franchisee enters into a direct lease with the third party owner. Although the franchisor has elected not to lease the premises itself, a prudent franchisor will attempt to obtain some control over the premises by way of a "conditional assignment" clause/agreement which will be discussed in greater detail in Section IV.4. below.

Before a lease is entered into between the owner and franchisee, the franchise agreement should require the franchisee to secure a location that meets franchisor's criteria and the franchisor should have approval rights over the lease form to ensure that the franchisee's lease contains various protections which are discussed in greater detail in Sections IV.4. and IV.5. of this paper.

(a) *Franchisee's Perspective*

The franchisee will have more control over the premises and its privity of contract with the owner gives the franchisee a right to exercise any renewal/extension options contained in the lease without relying upon the franchisor to exercise such options. The franchisee would also have contractual, common law and statutory rights and protections as against the owner/landlord. These advantages must be weighed against the following disadvantage: the franchisor has no obligations or liability under the lease (in the absence of an indemnity agreement or other form of security) and therefore, it does not offer any safety-net for the franchisee.

⁵ For a sample three-party Sublease (Shopping Centre), see *infra* note 13 at pp.10-25 to 10-29.

⁶ *Supra* note 2.

(b) ***Franchisor's Perspective***

The primary advantage of the franchisee being the tenant is that the franchisor has no contingent liability, unless the owner requires the franchisor to provide some form of security. Of course, this advantage must be weighed against the following potential disadvantages: (i) in the absence of an enforceable conditional agreement clause, the franchisor has little control over the premises; (ii) if the franchisee breaches the lease, the franchisor is limited to the contractual remedies available under the franchise agreement (and if applicable, the conditional assignment documents) as no landlord-type remedies will be available to it (i.e., no distress or re-entry, which is noted in Quebec may be less of a critical consideration); and (iii) the franchisor will have no right to interfere in the lease arrangement (except, perhaps, in the event of a default by franchisee under the lease if the franchisor successfully bargains for rights to cure and/or assume the lease).

If the owner/landlord insists on an unlimited indemnity from franchisor for the entire term of the franchisee's lease, then franchisor should re-consider entering the lease itself since it cannot avoid liability under the lease and with a direct lease the franchisor would maximize its control over the premises.

Even in the absence of a guarantee, indemnity or other form of security, there is a possibility that the franchisor could expose itself to liability under the lease in circumstances where the franchisor negotiated the lease on behalf of the franchisee and represented to the landlord that it would either take over the premises or arrange for a replacement tenant upon a default by the franchisee.⁷ Accordingly, franchisors should be wary of negotiating leases on behalf of the franchisee and making any statements which could be interpreted as a representation or warranty.

IV. HOW WILL THE LEASING ARRANGEMENT BE DOCUMENTED?

1. FRANCHISOR AS TENANT / FRANCHISEE AS ASSIGNEE

(A) *Assignment vs. Sublease*

If the franchisor has leased the premises directly from the owner of the property, now the franchisor must decide whether to assign the lease or sublease (or licence) the premises to the franchisee and several factors should be considered. A key factor will be the restrictions set out in the transfer provisions of the head lease and the owner's willingness to consent to an assignment or sublease if such consent is required under the head lease. For instance, the owner may grant the franchisor the right to sublease the premises to a franchisee without consent, but there may be no right to assign the lease to a franchisee without consent. Where consent is required for any assignment or sublease, the owner/landlord may advise that it is willing to consent to a sublease but not an assignment (which is

⁷ See *Kamitomo Holdings v. Pasula* (1983), 29 Alta. L.R. (2d) 375, 50 A.R. 280, 25 B.L.R. 60 (Q.B.). In this case a representative of the franchisor negotiated a lease for a Macleods dealership but the lease presented to the landlord named the franchisee as tenant. When the landlord refused to sign the lease without the franchisor's name on it, the Macleods representative advised: (i) Don't worry, Macleods never sign leases; (2) Macleods will take care of everything; (3) You are dealing with Macleods; and (4) if the dealer doesn't work then Macleods will either put a new dealer in or take over the store itself. After these promises were made, the landlord agreed to sign the lease. When the franchisee/tenant fell into arrears, the landlord claimed against the franchisor directly on the grounds that the oral representations made by Macleods amounted to an agreement to indemnify. The court found in favour of the landlord and ruled that the oral representations made by the franchisor amount to an indemnity which does not fall within the Statute of Frauds.

often the case). In Quebec, the right to either sublease or assign, subject to landlord consent acting reasonably, is of public order.

Where (i) the lease does not restrict the franchisor's ability to assign or sublease⁸, (ii) the franchisor has an automatic right under the lease to assign the lease or sublease the premises, or (iii) consent is required in both cases but the franchisor is able to obtain the landlord's consent to either transfer, then the franchisor needs to decide whether it will proceed by way of assignment or sublease.

It is important to remember that once a franchisor, as tenant, assigns his or her interest in the lease to a third party assignee, any privity of estate between the landlord and the franchisor is automatically terminated, but there is still a continuing privity of contract between such parties. At the same time, a privity of estate will be created between the landlord and the assignee but there will be no privity of contract between them. Therefore, once a franchisor assigns the lease to a franchisee, the franchisor remains liable to the landlord on the covenants contained in the lease, but has no right of re-entry to the property if the franchisee/assignee breaches the terms of the lease, unless the franchisor has specifically bargained for the right to cure the franchisee's defaults (see **Sample Clause 3**) or a "conditional assignment" agreement with the landlord (which is discussed in Section IV.4. below and see **Sample Clause 4**). As noted, in Quebec, the relationship whether as to an assignment or sublease will be based solely on privity of contract.

(B) Assignment & Tri-Party Agreement – What provisions to include?

To make an assignment of the lease more attractive to a prospective franchisee/assignee, the franchisor should also attempt to have a landlord acknowledge that once the lease has been assigned from one franchisee to another, then the landlord shall release the first franchisee from its obligations under the lease. In Quebec, unless otherwise stipulated, upon an assignment, the Assignor will be released from its obligations. That said, it is common practice for all Quebec landlord lease forms to provide for a stipulation that the assignor tenant will remain jointly and severally (solidarily) liable. Such a clause, once it has been negotiated with the landlord, might read as follows:

"In the event the Tenant transfers the Premises from one Franchisee ("First Franchisee") to another Franchisee who carries on the business at the Premises, then, in consideration of, an provided that the original Tenant forthwith upon request pays Landlord the balance of all or any Basic Rent and Additional Rent as defined in the Lease (including but not limited to the end of year adjustments) owing by the First Franchisee, and upon the new Franchisee providing Landlord with security in a form, amount and for a period acceptable to the Landlord, acting reasonably, to secure the due and punctual performance by the new Franchisee of its obligations under the Lease, then the Landlord shall release the First Franchisee from its obligations under the Lease, provided that the original Tenant shall not be released from its obligations under the Lease."

In order to retain some control over the premises following an assignment of the lease, the franchisor should attempt to negotiate an "optional assignment" or a "conditional assignment" clause (which are more particularly described in Section IV.4. of this paper) in a tri-party assignment or tri-party consent to assignment (where such consent is required under the lease) with the landlord and franchisee. Very briefly, an "optional assignment" provides for a re-assignment of the lease (at the franchisor's option) back to the franchisor at any time without landlord's consent, whereas a "conditional assignment" provides for a re-assignment of the lease (at the franchisor's option) back to the franchisor if and when the franchise agreement expires or is terminated before the lease expires. As well, the franchisor should

⁸In the absence of express restrictions in the lease, the law generally allows a tenant to freely sublet or assign his or her leasehold interest.

attempt to negotiate the other protections described in the “Conditional Assignment” paragraph in Section IV.4. of this paper.

2. FRANCHISOR AS TENANT / FRANCHISOR AS SUBTENANT

(A) *Why is a Sublease better for the franchisor?*

If the franchisor enters into a lease with the owner, typically the franchisor will sublease the premises to its franchisee (rather than assigning its leasehold interest) so the franchisor continues to have privity of estate and control over the premises upon termination of the franchise agreement.

If the parties proceed by way of sublease, the landlord-tenant relationship will be preserved between the head landlord and the franchisor, and a new landlord/tenant relationship will be created between the franchisor, as sublessor, and the franchisee, as sublessee. In the absence of a consent to sublease or a tri-party sublease agreement, there will be no privity of contract or privity of estate as between the owner and the franchisee/subtenant. As an example of this rule of privity of contract in Quebec, there is the case of *Dere et al v. Soltron Realty Inc. and Mmmuffins Canada Corp.* JE 2005-1371. In this case a sublease is entered into with a franchisee for a ten year term or two days prior to the termination of the head lease, which is co terminus with the franchise term. The sublease is subject to a head lease, which has a landlord right of termination after five years. The franchisee acknowledged that the sublease was subject to the head lease, but testified never in fact having seen the head lease. The Landlord exercised its right to terminate, whereby the franchisee filed an injunction to prevent the termination of the lease and sublease. The franchisee subtenant argued that the landlord acted abusively and unreasonably and that the landlord, by accepting rental cheques, had accepted subtenant's occupancy. The Court rejected these arguments out of hand and relied on the simple privity of contract rules to conclude that the franchisee could not prevent the termination of the head lease and therefore the sublease.

(B) *Franchisor Beware*

As previously mentioned, when a tenant effects an assignment of its lease, it transfers all of its interest in the lease and any privity of estate is lost. In contrast, a sublease is a transfer of only part of the tenant's leasehold interest; the tenant must retain part of the space or part of the term.

If, however, a tenant sublets all of the premises for the remainder of the lease term, then such sublease will constitute an assignment of the lease. The case of *Chater v. Elia*⁹ sets out the principle as follows:

"[I]f a tenant gives up his or her whole interest under a head lease by a purported subtenancy, the transaction is in law an assignment. In other words, there can be no sublease when there remains no tenancy to which the undertenancy is subordinated. In this case, the subtenancy related only to a portion of the premises demised under the head lease. Thus, the tenant did not, and did not intend, to give over to the "subtenant" his whole interest under the head lease. Therefore, there was in law no assignment."

Accordingly, if the tenant neglects to reserve the last day of the term of the head lease when granting a sublease, the sublease becomes an assignment by operation of law and the options contained in the lease may pass to the assignee.¹⁰

⁹ (1998), 16 R.P.R. (3d) 187 (N.S.C.A.) at page 192.

¹⁰ In the case of *Goldman v. 682980 Ontario Ltd.* (2002), 62 O.R. (3d) 21 (Ont. C.A.), a sublease had been granted to a subtenant for the balance of the lease term. The lease contained an option to purchase in favour of the tenant which had to be exercised prior to the expiry of the term of the lease. When the tenant exercised the option to purchase, the landlord

In *Damack Holdings Ltd. v. Saanich Peninsula Savings Credit Union et. al.*¹¹ this precise issue arose in the context of a franchisor's sublease to its franchisee. The court held that although the franchisor and franchisee intended a sublease, because the franchisor did not retain a reversionary interest in the lease, but disposed of the whole term of the head lease, the document operated as an assignment of lease. The court allowed the franchisee to remain in possession of the leased premises, even though the franchise agreement had been terminated. In Quebec no related issues as to reversionary interest exist, such that a sublease cannot become an assignment, each being under law, two distinct legal agreements.

(C) ***Owner Beware***

In some circumstances the owner/landlord may owe the subtenant/franchisee a duty of care even in the absence of any privity of contract. In *Country Style Food Services Inc. v. 1304271 Ontario Ltd.*¹² the head lease contemplated that the premises would be subleased to a franchisee. The head lease contained a copy of a site plan that depicted the location of the franchisee's shop and drive-through facility, as well as the roadways, planned parking and the proposed commercial retail building in close proximity to the franchisee. When construction was completed the complex differed significantly from the original site plan and access to the franchisee's operation was restricted, resulting in reduced sales and profits. The trial judge held that (i) the landlord possessed specific and unique knowledge of the circumstances regarding the complex and a special relationship of proximity existed between the landlord and franchisees that gave rise to a duty of care; (ii) site plan misrepresented the development and that the franchisees relied upon it to their detriment; and (iii) the franchisor breached the duty of good faith owed by it to the franchisees. The judge awarded damages to the franchisees of \$400,000.00 against both the landlord and franchisor. The Ontario Court of Appeal held that the trial judge did not err in finding the landlord liable on the basis of misrepresentation. In obiter, the Court of Appeal supported the trial judge's view that while the franchisor was not obligated to commence a lawsuit against the landlord on behalf of the franchisees, it had a duty not to send conflicting messages by telling the franchisees that it would take steps and then taking none other than to enforce its own agreements with the franchisees.

In *University Health Network v. Made in Japan Japanese Restaurants Ltd.*¹³ the University operated a hospital and leased the food court in the hospital to Made in Japan Japanese Restaurants and Mrs. Vanelli's Restaurants, which in turn sublet to two franchisees whose businesses failed within eight months. University Health Network brought an application to claim arrears of rent and prospective rent for the balance of the lease term. The franchisees brought an action against University and the franchisors. In the context of the motion, the Court stated that it cannot be presumed that a landlord does not owe a duty to a subtenant/franchisee where it knew that the premises were being sublet during the lease negotiations and where it also knew the impact its representations would have on the franchisee's

brought an application for a declaration that the option was no longer exercisable by the tenant. In taking this position, the landlord proposed that when the tenant purported to grant a sublease, it in fact made an assignment of the lease because the tenant had neglected to reserve the last day of the term of the lease. Therefore, it was the assignee (and not the tenant) who had standing to exercise the option to purchase, and since the assignee did not exercise the option to purchase prior to the expiry of the term, the option was null and void. The lower court agreed with the landlord that there had been an assignment, and found that the option to purchase had passed to the assignee at the time of assignment and therefore could not be exercised by the tenant. This decision was overturned on appeal. The Ontario Court of Appeal agreed with the lower court's decision that the sublease became an assignment by operation of law, but based on the particular facts of this case, the Court of Appeal held that the option to purchase (in contrast to the other provisions) did not get assigned because the optioned premises were different than the demised premises.

¹¹ (1982) 19 B.L.R. 46 (B.C.S.C.).

¹² [2003] O.J. No. 362 (Ont. S.C.J.), affirmed (2005) 200 O.A.C. 172 (Ont. C.A.).

¹³ [2003] O.T.C. 451, 123 A.C.W.S. (3d) 259 (Ont. S.C.J.).

business. The Court found that the landlord had overstated the number of full time employees at the hospital which in turn severely affected the performance of the franchised businesses.

(D) ***Franchisee’s Sublease – What provisions to include?***¹⁴

The following provisions should be included in a sublease between the franchisor, as sublandlord, and the franchisee, as subtenant:

(a) ***Franchisee’s Sublease - Franchisor’s Perspective***

- ***Term:*** For the reasons mentioned in Section IV.2.(B) above, the franchisor should reserve the last day of the head lease term and therefore, the sublease term cannot exceed the term of the head lease less one day. And as previously mentioned, the terms of the sublease and the franchise agreement should be co-terminus.¹⁵
- ***Use:*** Ensure that the franchisee/subtenant is only authorized to conduct the franchised business in accordance with the underlying franchise agreement. This use restriction should eliminate the possibility of an assignment (by the franchisee) to a new person or entity who has not been approved by the franchisor as a franchisee. It also improves the franchisor’s control in circumstances where the franchisee becomes bankrupt because the bankruptcy trustee may have difficulty assigning the sublease to a new subtenant without violating the use clause unless the bankruptcy trustee cooperates with the franchisor.¹⁶
- ***Rent:*** In the head lease, be sure to watch out for an escalation in rent which could be triggered by a sublease and any right in favour of the landlord to collect all excess rent from the franchisor. Either delete such provisions or amend them so they do not apply to any sublease (or assignment) to a franchisee. In the sublease, the definition of “additional rent” should include royalties, service fees, advertising contributions and other amounts owing by the franchisee to the franchisor under the franchise agreement. This allows the franchisor to exercise the landlord remedies available under the sublease or at law, including distress or re-entry, if the franchisee does not pay amounts payable under the franchise agreement.
- ***Cross-Default Clause:*** As previously mentioned, a default under the franchise agreement should constitute a default under the sublease and vice versa. This would entitle the franchisor to obtain possession of the premises upon any default under the franchise

¹⁴ For a sample Franchisor/Franchisee Sublease, see the “Forms and Precedents” Section of Zaid, Frank, ed., *Canadian Franchise Guide*, vol. 3 (Toronto: Thomson Canada Limited, 2006) at pp. 10-10 to 10-17.

¹⁵ The case of *TDL Group Ltd. v. 1060284 Ontario Ltd.*, [2000] O.J. No. 3868, 100 A.C.W.S. (3d) 233 (Ont. S.C.J.) illustrates that franchisors may control premises occupied by franchisees by having the term of the franchise agreement remain coincident with the term of the sublease. The franchisees submitted that because of the long-standing good relationship with the franchisor, the franchisees had a reasonable expectation that the franchise agreement would be renewed and alleged bad faith on the part of the franchisor. The court held when a party enters into an agreement which contains no right or option to renew on ascertainable terms, there will be no renewal enforceable by a court and the long-term profitable relationship did not give rise to any obligation on the franchisor to renew the agreements. Therefore, if the term of the sublease expires and the term of the franchise agreement is coincident with the sublease term, the franchisor is under no legal obligation to continue to sublease the premises to the franchisee, notwithstanding that the franchisor may be entitled to remain in possession of the premises pursuant to the head lease. Also see *Hamburg Honda v. Honda Canada Inc.*, [2009] O.J. No. 5152, 183 A.C.W.S. (3d) 221 (Ont. S.C.J.), the Court found that neither party (the sublandlord and subtenant) is required to allow the term to be renewed. Further, that neither party has any reasonable expectation of a renewed term.

¹⁶ The same principle would apply for a lease (as opposed to a sublease) between the franchisor and franchisee where the franchisor owns the premises.

agreement and the franchisee is reduced to seeking relief from forfeiture.¹⁷ Also include an acknowledgement in both the sublease and franchise agreement that the franchisor is entitled to exercise its landlord remedies by virtue of such cross-default clause. The sublease should also provide that any uncured breach of the franchise agreement, sublease, head lease or any other contract made between the franchisor and franchisee, entitles the franchisor, at its option, to immediately re-enter, take possession of premises and remove signage without notice or demand and thereupon immediately terminate the sublease, without prejudice to its other rights and remedies.

- **Compliance with the Head Lease:** The sublease should require that the franchisee observe and perform all of the franchisor's obligations, as tenant, under the head lease, as if they were part of the sublease.
- **Compliance with the Franchise Agreement:** The sublease should require the franchisee to perform all its obligations under the franchise agreement and all other related documents (including any development agreement, security agreement, etc.).
- **Franchisee Acknowledgement:** Have the franchisee acknowledge that: (i) it has received and examined a copy of the head lease (a copy of which should be annexed to the sublease); and (ii) the sublease is expressly made subject to the provisions of the head lease, all of which are incorporated into the sublease *mutatis mutandis*.
- **Restrictions on Transfers:** Stipulate *inter alia* that the franchisee cannot assign the sublease or sub-sublet the premises without the franchisor's prior written consent (which ideally can be arbitrarily withheld, although in Quebec a franchisor would need to act reasonably) and it must be in conjunction with a simultaneous transfer of the franchise agreement. In theory and in practice, linking the consent to transfer to the franchise agreement would be seen as reasonable.
- **Head Landlord Consent:** If the head landlord's consent is required under the head lease, ensure that such consent has been obtained before the sublease is executed, or alternatively, make the sublease conditional upon obtaining such consent.
- **Conflicts between documents:** Subleases often provide that in the event of a conflict or inconsistency between the terms of the sublease and the franchise agreement, the franchise agreement will prevail. Not surprisingly, the landlord will usually insist that the consent document (where such consent is required under the head lease) stipulates that in the event of a conflict between the terms of the sublease and the head lease, the head lease prevails.

(b) **Franchisee's Sublease - Franchisee's Perspective**

- **Head Landlord Consent:** Same comments as above.
- **Location:** Generally avoid signing the franchise agreement until the location has been determined and approved by the franchisee. If it must be signed before then, include requirements, conditions and timing applicable to site selection. If possible, bargain for a refund of the franchisee's initial fees if a mutually agreeable site has not been determined by a specified deadline.

¹⁷ As long as the franchisee pays all arrears owing and compensates the franchisor all non-monetary defaults, a court may be willing to grant relief to a franchisee pending a trial of the issues relating to the termination of the franchise agreement pursuant to the cross-default clause.

- **Premises:** Negotiate whether: (i) the franchisor has any approval rights over the initial build-out by the franchisee; (ii) the franchisee needs/wants assistance from the franchisor regarding site selection, preparation of plans, construction and/or financing; and (iii) the franchisee wants “turn-key” premises from franchisor and certainty regarding the scheduled delivery date.
- **Term:** The franchise agreement and sublease should be co-terminus with identical renewal timelines that are triggered by the same method.
- **Rent:** The franchisee probably expects to benefit from the franchisor’s ability to negotiate a favourable (lower) rental rate. Beware: the franchisor may attempt to profit on the real estate by charging the franchisee a higher base rental rate than the rate payable under the head lease.
- **Assignment vs Sublease:** If the franchisee is unable to take an assignment of the lease, it could attempt to procure an assignment by operation of law (by making the term of the sublease coincident with the term of the head lease). (see Section IV.4.(B)) In terms of permitted transfers, the franchisee should negotiate for the right to assign the sublease or sub-sublet the premises to certain permitted transferees such as: (i) a subsidiary, parent or affiliated corporation of the franchisee; (ii) a corporation formed as a result of a merger or amalgamation of the franchisee with another corporation; (iii) a recognized lending institution as collateral security for the financing of the franchisee’s undertaking; and (iv) a party that acquires the franchisee’s sub-leasehold interest in the premises provided such party engages in the permitted use.
- **Options:** If the franchisee is a subtenant (as opposed to an assignee), it will not be entitled to exercise any renewal/extension options in the head lease. Accordingly, the sublease should include a covenant from the franchisor to exercise its corresponding renewal/extension rights in the head lease when the franchisee exercises its options under the sublease and the franchise agreement (or at the very least, use best efforts to renew/extend the head lease and to grant the same renewal/extension term to the franchisee through a renewed or extended sublease). Also try to obtain all indemnity for losses suffered or a right to relocate, in the event the franchisor fails to renew/extend as aforesaid.
- **Rent:** The franchisor may attempt to charge the franchisee a higher base rent under the sublease. Ensure there is no rent “spread” or at least be aware of it beforehand.
- **Compliance with the Head Lease:** If the sublease requires the franchisee to be bound by and perform all obligations of the franchisor under the head lease, be sure to carefully review the head lease thoroughly.
- **Cross-Default:** If possible, avoid a cross-default clause.
- **Other Franchisor Covenants:** The franchisee should seek the following covenants from the franchisor:
 - peaceful and quiet enjoyment of the premises for the term of the sublease;
 - to comply with the franchisor’s obligations under the sublease, the head lease and the franchise agreement; and
 - to take all necessary action to enforce the covenants and obligations of the head landlord under the head lease for the benefit of the franchisee.

3. **FRANCHISOR AS TENANT / FRANCHISEE AS LICENSEE**

In lieu of granting a sublease or assignment to the franchisee, the franchisor could simply grant a license to use the premises. As long as the document (a license agreement or occupancy agreement) is properly drafted, the franchisee will have no leasehold interest in the premises and no landlord-tenant relationship will arise. As previously mentioned, in the absence of a landlord-tenant relationship the franchisee will not have any of the usual tenant rights and protections (including the statutory right to apply for relief from forfeiture¹⁸ or for an order vesting the remaining head lease term in the franchisee if the franchisor's interests are terminated under the head lease¹⁹) and the franchisor would have no obligation to comply with the statutory notice provisions or any other restrictions under the landlord-tenant legislation or at common law. Of course, these benefits to the franchisor must be weighed against the costs associated with being limited to contractual remedies in the event of default by the franchisee/licensee. In other words, for a licensed occupancy the franchisor could not pursue landlord-type remedies such as distress against the franchisee's goods and chattels on the premises.²⁰

4. **FRANCHISEE AS TENANT**

(A) ***Franchisee's Lease -- What provisions to include?***

A prudent franchisor should ensure that, *inter alia*, the following concepts are addressed in the lease (which the franchisor executes to ensure privity of contract) or a tri-party agreement between the owner, as landlord, and the franchisee, as tenant (see **Sample - Addendum to Lease** annexed hereto):

- ***Execution:*** Any tri-party agreement or "conditional assignment" agreement should be executed concurrently or both documents should be conditional upon execution of the other. The same holds true for the franchise agreement.
- ***Timing & Options:*** Ensure that the franchisee's lease and the franchise agreement are co-terminus. As well, any option to renew or extend either document should be conditional upon: (i) the simultaneous renewal/extension of the other by the franchisee; and (ii) the franchisee's option to renew/extend the franchise agreement should be conditional upon the franchisee not being in default under the lease or any other related document.
- ***Default:*** The default provisions of the franchisee's lease should require the landlord to simultaneously deliver to the franchisor copies of all default notices sent to the franchisee and provide the franchisor with additional time to cure the default if the franchisee fails to do so.
- ***Franchisor Clauses:*** A prudent franchisor should attempt to include the following clauses (individually and collectively referred to herein as "franchisor clauses") in the franchisee's lease (subject to the "privity of contract" requirements hereinafter described) or a separate tri-party agreement:

¹⁸ Section 20(1) of the *CTA* (*supra* note 2).

¹⁹ Section 21 of the *CTA* (*supra* note 2).

²⁰ An occupancy agreement would also reap possible benefits to the landlord and franchisor in the event of bankruptcy of the franchisee. This issue is discussed in greater detail in Section IV of the paper authored by Sheldon L. Disenhouse entitled "Leasing Aspects of the Franchise Relationship" which was presented at the International Council of Shopping Centres Canadian Shopping Centre Law Conference, March 7-8, 1996.

- **Right to enter and modify the Premises** - Reserve a right in favour of the franchisor to enter the premises from time to time to make any modifications necessary to conform the premises to changing standards and specifications of the franchise system or franchisor.
- **Right to Temporarily Operate** - Acknowledgement from the owner/landlord that in the event of the franchisee's default, the franchisor is entitled to exercise its rights under the franchise agreement to enter the premises and operate the business for the account of the franchisee without such entry and operation constituting an assignment or sublease.
- **Franchisor's Right to Approve the Lease** - The franchisor must have the right to approve the form of lease which should contain certain minimum provisions to protect the franchisor's interest in the premises (see **Sample Lease clause in Section IV.6. of this paper**) which may include, *inter alia*, the following concepts: (1) all notices of default should be delivered simultaneously to the franchisor; (2) an opportunity to cure the franchisee's default(s); (3) an acknowledgement by the franchisee that the landlord is authorized to disclose to the franchisor any information furnished by the franchisee; and (4) have the franchisee acknowledge that by executing the lease, it has authorized and does automatically assign all of its rights, title and interest in the lease and the premises to the franchisor (or a replacement franchisee designated by the franchisor) upon the expiry or earlier termination of the franchise agreement.
- **Other Franchisor Approval Rights** - Seek covenants from the owner and franchisee that: (i) no assignment or subletting, (ii) amendments to lease, or (iii) surrender, cancellation or termination of the lease by the franchisee will be effected without the franchisor's prior consent. Ideally the franchisor would be able to arbitrarily withhold such approval. In addition, the franchise agreement should provide that if the franchisee breaches such restrictions (e.g., surrendering the lease or proceeding with a lease amendment without the franchisor's approval), then the franchisee will indemnify and save harmless the franchisor from any and all costs, expenses, losses, claims and damages suffered by the franchisee in connection with such breaches.
- **"Optional Assignment"** – Ideally, the lease (or tri-party agreement) would grant the franchisor an option to obtain an assignment of the lease from the franchisee at any time, without the landlord's consent, and if the franchisor exercises such option it will take possession of the premises upon the terms and conditions in the lease provided the franchisor's liability is limited to the period between the date on which the franchisor exercised its option to take such an assignment and the date on which the lease is assigned to a new franchisee. (See **Sample Clause in Section IV.6.** of this paper)
- **Conditional Assignment** – If the landlord rejects a broad "optional assignment" clause, then the franchisor should (at the very least) bargain for a "conditional assignment" clause in the lease or a separate "conditional assignment" agreement, which is/are described in greater detail below.

In order for the "franchisor clauses" described in this Section IV.4. to be enforceable by the franchisor against the owner/landlord, there must be privity of contract between them.

Accordingly, if any of the aforementioned “franchisor clauses” are contained in the lease, the franchisor must be a party to the lease, but it should seek the following acknowledgements from the landlord and franchisee to limit the franchisor’s exposure: (i) the franchisor has signed the lease only for the purpose of the franchisor clauses specifically listed; and (ii) until it exercises its rights pursuant to the “conditional assignment” clause (or the “assignment option” clause, as the case may be), the franchisor has no liability whatsoever to perform the terms or conditions of the lease (unless, of course, the franchisor has also signed an indemnity agreement). Alternatively, any or all of these franchisor clauses can be included in a separate tri-party agreement entered into by the owner, the franchisee and the franchisor. Under the *Civil Code of Quebec*, terms are provided under Articles 1444 to 1450, as to stipulation for another, where such rights would be enforceable without regard to privity of contract. However, as such stipulation rights may be revoked and as to other limitations that may exist, either an intervention or tri-party agreement are nonetheless more commonly provided for.

- ***Tri-party Agreement:*** If the franchise agreement contemplates a tri-party agreement among the landlord, franchisee and franchisor, both the lease and franchise agreement should be conditional upon such agreement being fully executed in a form satisfactory to the franchisor.

- ***“Conditional Assignment” clause/agreement:***
 - A “conditional assignment agreement” would permit the franchisor to obtain an assignment of the franchisee’s leasehold interest under the lease in the event the franchise agreement expires or is terminated for any reason. (See **Sample Clause 4**)²¹
 - Ideally, the conditional assignment would also provide that after taking an assignment of the lease, the franchisor has a further right to assign the lease or sublet the premises to a new franchisee without obtaining the landlord’s consent and (if possible) without continuing as primary obligator.
 - Since the franchisor has a right to assume the lease in these circumstances, the franchisor gains some control over the premises. Of course, the franchisor does not have nearly as much control over the premises as it would have had as a direct tenant under the lease.
 - At first glance, the “conditional assignment” concept appears to address the franchisor’s concerns about controlling the premises in a default scenario, but there may be some practical problems to overcome. If the franchisor terminates a franchise agreement following an alleged default but the franchisee disputes the default and challenges the termination, the owner/landlord may be loathe to get involved in this dispute. As a result, the franchisor may have to apply to court for injunctive relief to enforce the conditional assignment and there may be a delay before the franchisor can effect the lease assignment.

5. **FUNDAMENTAL TERMS OF ANY LEASE WITH A 3RD PARTY OWNER IN A FRANCHISE SYSTEM**

Regardless of who (franchisor or franchisee) enters into a lease directly with the third-party owner, it is essential that various lease provisions be negotiated to cover certain fundamental aspects of the franchise relationship, including the following:

²¹ For a sample form of “Conditional Assignment of Lease”, see *supra* note 13 at pp.10-34.2 to 10-37.

- **Term** – Both franchisors and franchisees benefit from obtaining a lease term which is of sufficient duration to be an asset to the franchise business. It is also important, as previously mentioned, to ensure that the term of the lease (and any renewal or extension options) coincide with the term of the franchise agreement (and any options therein). While the situation is somewhat uncommon, the Supreme Court, in the matter of *Uniprix Inc. v. Gestion Gosselin et Bérubé Inc.* 2017 CSC 43, held that a clause which allowed a perpetual and automatic right of renewal of an affiliation agreement, which for all intent and purpose would be similar to a franchise agreement, in favour of the affiliate or franchisee, is valid and opposable.
- **Use Clause** – Attempt to negotiate the use clause to allow the business to expand without having to obtain the consent of the owner/landlord. Both the franchisor and franchisee would benefit from a broadly drafted use clause which covers goods and services sold by the franchisor as its business evolves. For instance, the use clause could be tied to goods and services sold in the majority of the franchisor’s stores from time to time. In addition, if the franchisor enters into the lease directly with the landlord/owner, it may want to have the right to change its use in case it has difficulty finding a replacement for a defaulting franchisee.
- **Exclusive Use** – Seek a covenant from the owner/landlord not to lease, use or occupy (or permit to be leased, used or occupied) any other premises in the development to another person or entity whose products compete with those of the franchisor. If the landlord insists that you specify the goods and services covered by the restrictive covenant, the tenant should attempt to extend the exclusive to those goods and services that may be sold in the majority of the franchisor’s stores from time to time provided such goods and services do not breach any then existing exclusive use provisions which may have been granted by the owner to other tenants of the development, notice of which has been delivered to the tenant (or within a specified number of days after the tenant has requested a copy of such existing exclusives).
- **Determination of Rent** – In lieu of costly audited statements, offer the landlord a statement of gross sales signed by the tenant’s senior financial officer. If this is insufficient for the landlord’s purposes, offer to have such statement reviewed and certified by the franchisor’s or landlord’s accountants.
- **Records** – If the lease requires a certain type of cash register or system of maintaining records, amend this clause to make it compatible with those maintained by the franchisor/franchisee under the franchise system.
- **Radius Clause** – Resist any radius clause so that the franchise system can expand into other developments within the same market area. If the owner insists on such a clause, attempt to limit the radius and exempt any possible expansion locations.
- **Signage** – Have the landlord waive its approval rights (or have it confirm its consent in the lease) to any and all signage which is consistent with the corporate criteria and identity utilized in a majority of the other stores operating within the franchise system, either of which may be altered and/or upgraded from time to time.
- **Leasehold Improvements** – Attempt to have the landlord waive its approval rights over the installation of non-structural leasehold improvements, or have it consent in the lease: (i) to initial improvements so long as they are interior non-structural improvements which are consistent with the franchisor’s corporate design criteria; and (ii) any alterations and/or

upgrades thereto, if such changes are part of a system-wide replacement or upgrading program. To maximize its flexibility, the tenant should propose a clause similar to the following:

“Notwithstanding the foregoing, the Tenant may make such interior non-structural alterations, improvements and additions to the Premises, including, without limitation, changing colour schemes, installing new countertops, flooring, wall-covering and modifying the layout of the tenant fixtures, as the Tenant deems necessary or desirable without obtaining the Landlord's consent.”

If the tenant wants the right to finance its trade fixtures and/or leasehold improvements, the tenant should delete any prohibitions contained in the lease pertaining thereto and resist any landlord approval rights in connection with such financing. Alternatively, the tenant should seek to insert an clause wherein the landlord acknowledges that: (i) the tenant may assign the lease to a recognized lending institution as collateral security for the financing of the tenant's undertaking; and (ii) nothing in the lease shall restrict the tenant from creating security in its goods, fixtures, furnishings and other tangible assets situated (or to be situated) on the premises provided such security arises out of a bona fide financing undertaking in the course of the general business operations of the tenant.

- ***Default Provisions*** – In many leases the bankruptcy or insolvency of any occupant of the premises triggers a non-curable default. Where a franchisor enters into a lease with the owner, the franchisor should delete these references to “occupant” to avoid losing the premises and its leasehold interest if the franchisee becomes bankrupt or insolvent. Where the franchisee has entered into a direct lease with the landlord, a prudent franchisor should seek an acknowledgement from the landlord in a tri-party agreement that any bankruptcy or insolvency of the franchisee/tenant will not trigger a lease termination provided the franchisor promptly takes control of the premises and continues to operate the business (corporately or by replacing the franchisee) in compliance with the lease. Notwithstanding such acknowledgement, the franchisor may be prevented from taking control of the premises if the franchisee's bankruptcy trustee elects to retain the franchisee's lease or sublease, as the case may be, pursuant to applicable bankruptcy legislation.
- ***Estoppel Certificates*** – Since a franchisor often sublets to a franchisee, and since a franchisee leasing (or subleasing) the premises may want to sell its franchised business, attempt to obtain a covenant from the landlord to provide an estoppel certificate in such cases. An estoppel certificate may also be necessary to facilitate financing of the franchised business.
- ***Insurance*** – Ensure the insurance requirements are consistent with those contained in the franchise agreement and they should not be more onerous than those contained in any blanket policy maintained by the franchisor. Out of an abundance of caution, seek to include the following clause in the lease:

“Notwithstanding anything to the contrary contained in this Lease, all policies required to be maintained by the Tenant under this Section may be scheduled policies or blanket policies covering other locations and assets of the Tenant [and/or Franchisor] provided, however, that should the coverages, amounts, forms and deductibles contained in the Tenant's blanket policies from time to time in force not fulfil all of the minimum requirements and obligations of the Tenant

pursuant to this Lease, the Tenant shall be deemed to be self-insured and to have fulfilled its obligations under this Lease insofar as these matters are concerned.”

■ **Assignment/Subletting –**

- For the reasons already explained, the franchisor wants to maintain control over the location if the franchise agreement expires or is terminated for any reason before the lease term expires. To improve its control, the franchisor should seek broad rights to assign or sublet to affiliated corporations and franchisees or licensees without the landlord’s consent. The franchisor may also want the right to assign the lease to a purchaser acquiring all or substantially all of the assets of the franchisor without the landlord’s consent, otherwise the landlord could delay or jeopardize the entire purchase and sale transaction.
- There should be an exemption in the lease allowing for a change in control of the franchisor, otherwise the lease may hinder financing and business transactions which involve the transfer of shares of the franchisor corporation. In addition, the franchisee should attempt to amend its lease to include a landlord acknowledgement that no consent is required for certain changes in effective voting control, such as: (a) the death of any shareholder of the tenant; or (b) the sale or transfer of shares to (i) any member of the respective families of the franchisee’s shareholders, (ii) any corporation owned or controlled by the franchisee’s shareholders, or (iii) any trust for the families of the franchisee’s shareholders.
- As previously mentioned, since many commercial leases provide for a bump in base rent which is triggered by a transfer, the franchisor should attempt to delete such provisions or ensure they do not apply to any assignment or sublease to a franchisee (or other “permitted transferee” described in the lease).
- Many leases also contain recapture rights which give the landlord the right to terminate the lease in lieu of consenting or withholding its consent to a proposed transfer. Try to delete such termination right or ensure it does not apply to any assignment or sublease to a franchisee (or other permitted transferee) whether or not consent is required therefor.
- From the franchisor’s perspective (where the franchisor is the tenant), it should bargain for permitted (i.e. non-consent) transfers which may include the following:

“Notwithstanding anything in this Lease to the contrary, the Tenant may assign the Lease or sublease or license all or part of the Premises from time to time, without obtaining the consent of the Landlord (but upon prior notice to the Landlord) to:

- (a) to parent, affiliate, associated or subsidiary corporation (as such terms are defined in the *Canada Business Corporation Act*) of the Tenant; or
- (b) to a corporation with which the Tenant amalgamates; or
- (c) as part of a bona fide corporate reorganization of the Tenant; or
- (d) to a purchaser acquiring no less than ● (●) stores operating under the same trade name as the Tenant is using in the Premises; and
- (e) to a bona fide franchisee or licensee of the Tenant.”

Also see the heavily negotiated **Sample Clause 1.**

In addition, the franchisor should attempt to make an assignment of the lease more attractive to a prospective franchisee by including in its lease a landlord acknowledgement (similar to the **Sample Clause described in Section IV. 1.(B)** of this paper) which releases a vacating franchisee upon an assignment to a new franchisee.

- From the franchisee's perspective (where the franchisee is the tenant), it should *inter alia* attempt to bargain for certain permitted transfers (and the franchise agreement should require it to do so) which may include those contained in **Sample Clause 2**.
- From the landlord's perspective, it should consider imposing various restrictions on permitted transfers to a franchisor/franchisee. (See **Sample Clauses 5, 6, 7 and 8**)

6. PROVISIONS TO INCLUDE IN THE FRANCHISE AGREEMENT

The focus of this paper is to highlight the various leasing arrangements available to franchisees and franchisors and to discuss the provisions which should be included in a lease, sublease, occupancy agreement, and/or tri-party agreement, depending on who owns the property. As an aside, it is worth briefly mentioning that the franchise agreement should, *inter alia*, address the following issues:

- if the premises are known, clearly identify them in a schedule attached to the franchise agreement;
- if the premises are unknown, stipulate whether the parties must identify and agree upon the terms and conditions relating to the premises within a certain time following execution of the franchise agreement;
- if the site is not available at the time the franchise agreement is signed, consider whether it should be conditional on signing a site development agreement;
- the definition of “gross sales” or “gross revenue” in the lease should be mirror the definition found in the franchise agreement;
- whether franchisee is permitted to use the leased premises for the operation of any other business;
- whether the franchisee must execute the franchisor's standard form of lease/sublease agreement in conjunction with the execution of the franchise agreement;
- whether or not a cross-default clause applies and if so, an acknowledgement that the franchisor is entitled to exercise its landlord rights under the applicable landlord and tenant legislation by way of the cross-default clause;
- who (franchisor or franchisee) will prepare plans and specifications for the initial fixturing work;
- who is responsible for securing a suitable location, construction and development. If the franchisor is responsible, detail the franchisor's financial and work obligations;
- whether the franchisor is required to consent to the location at the time the franchisee enters into lease;
- *from the franchisee's perspective*, avoid signing the franchise agreement until suitable location has been found and the lease signed, or bargain for a termination and return of fees upon expiry of the deadline;
- *from the franchisor's perspective*, the franchise agreement should be conditional upon the landlord, franchisee and franchisor entering into a tri-party agreement in a form acceptable to the franchisor, which gives the franchisor some control over the premises;
- a prudent franchisor should include a “power of attorney” clause in the franchise agreement whereby the franchisee appoints the franchisor as irrevocable attorney to do any act which the franchisee is obligated to do with respect to an assignment of the franchisee's lease or sublease, as the case may be; and
- if the franchisee will be entering into a lease directly with the owner/landlord, a prudent franchisor should ensure that the franchise agreement (i) gives the franchisor approval rights over the lease, and (ii) contains some minimum restrictions regarding the lease form. A sample clause which may be inserted in the franchise agreement is as follows:

Lease

The Franchisee acknowledges having approved the location of the Store. The Franchisee shall enter into a formal lease (the "Lease"), as Tenant, for certain store premises (the "Leased Premises"). The Franchisee acknowledges that the Franchisor took no part in obtaining or negotiating the Lease on the Franchisee's behalf. At the Franchisee's option, it may also enter into an offer to lease ("Offer") prior to entering into the Lease.

Prior to executing an Offer (if applicable) and the Lease, the Franchisee shall deliver a copy of the proposed Offer or Lease, as the case may be, to the Franchisor for its written approval of the terms and conditions contained therein, acting reasonably, and the Franchisee shall be liable to reimburse the Franchisor for its reasonable costs and expenses for such review, including without limitation, the Franchisor's reasonable legal fees and expenses.

Without limiting the generality of the foregoing, the Lease and (if applicable) the Offer shall contain the following clause, and the Franchisee acknowledges and agrees that it shall be reasonable for the Franchisor to withhold its approval to same unless such clause is contained therein:

"The Landlord acknowledges that _____ (the "Franchisee"), has entered into a Franchise Agreement with ● (the "Franchisor") to operate a ● store from the Leased Premises. Contemporaneously with the execution of this Lease by the Franchisee, it shall arrange to have the Landlord and Franchisee execute the Addendum to Lease Agreement attached hereto as Schedule "●", whereby each acknowledges that the Franchisor shall have the option to obtain an assignment of this Lease from the Franchisee, without the Landlord's consent but upon written notice to the Landlord. In such event, the Franchisor shall be entitled to take possession of the Leased Premises for the remainder of the Term, upon the terms, covenants and conditions in this Lease, including, without limitation, the Tenant's rights to further assign the Lease in accordance with the transfer provisions set out in this Lease, subject to the following paragraph. Upon such assignment, the Franchisor shall be liable for the fulfillment of all of the Tenant's obligations under this Lease during the period between the date on which the Lease is effectively assigned to the Franchisor and the date on which the Lease is assigned to another bona fide franchisee of the Franchisor. The Landlord agrees with the Franchisor that it will deliver any notice of default pursuant to Lease, to the Franchisor, contemporaneously with the delivery of notice of default to the Tenant, and the Franchisor shall have the right to cure such default.

Notwithstanding anything in the Lease to the contrary, the Landlord agrees that: (i) the Franchisee/Tenant may, without the Landlord's consent but upon written notice, assign this Lease and its interest in the Leased Premises to the Franchisor, provided that until the Franchisor assigns the Lease to another franchisee, the Franchisor agrees to be bound by all of the terms, covenants and conditions contained in this Lease pertaining to the Tenant; and (ii) at any time after the Lease is assigned to the Franchisor, it may, without the Landlord's consent but upon written notice, assign the Lease to a bona fide franchisee of the Franchisor provided such franchisee agrees to be bound by all of the terms, covenants and conditions contained in this Lease as if the new franchisee had originally executed the Lease as Tenant. It is understood and agreed that an assignment by the original Tenant to the Franchisor or an assignment by the Franchisor to another franchisee described above shall not relieve the original Tenant from the performance of the terms, covenants and conditions contained herein on its part to be observed and performed and the original Tenant shall remain primarily liable under the Lease after any such assignment."

A copy of the aforementioned Addendum to Lease Agreement is annexed hereto as Schedule "●".

The Franchisee hereby covenants and agrees with the Franchisor that throughout the Term of the Lease (and any renewal or extension thereof) it will not surrender, cancel, terminate or replace the Lease and it will not amend the Lease in any manner, without first obtaining the Franchisor's prior written approval."

V. BANKRUPTCY: RIGHTS OF THE PARTIES WITH RESPECT TO THE PREMISES

Most leases provide that if the tenant, or anyone permitted by the tenant to be in possession of the premises, becomes bankrupt or insolvent, the landlord is entitled to re-enter the premises and to terminate the lease. However, the landlord's remedies are limited by provincial landlord and tenant legislation and by the federal *Bankruptcy and Insolvency Act*²² (the "BIA"). While landlord and tenant legislation is similar in most of the provinces of Canada, there are some differences and in this chapter, reference will be made only to the CIA. Sections 38 and 39 of the CIA set out the rights of various affected parties in the event of the bankruptcy of a tenant or other occupant of the leased premises.

The provisions of the BIA which deal with proposals, provide a mechanism within the BIA for insolvent debtors to re-organize, and are of particular interest to landlords and tenants. These provisions enable an insolvent tenant (an individual, corporation, partnership, etc.) to file a proposal with a view to, among other things, compromise the claims of landlords.

A proposal filed by an insolvent tenant may provide that the landlord is to file proof of claim for actual losses resulting from the disclaimer (the term "actual losses" can be defined by the parties in the lease). or a proposal may allow for an amount equal to the lesser of:

- (1) the aggregate of:
 - a. the rent next coming due under the lease for the first full year following the effective date of the disclaimer, and
 - b. fifteen percent of the rent that is payable for the remainder of the term from and after this first full year; and
- (2) three years' rent.

The right to disclaim a lease is obviously of interest and concern to both franchisors (who may, in varying circumstances, find themselves in the position of a landlord or tenant), and franchisees (who generally find themselves in the position of tenant).

a. Bankruptcy of the Franchisor

If the franchisor as tenant becomes bankrupt, the trustee in bankruptcy has the right to occupy the premises for up to three months following the bankruptcy and during that time to elect to either: (a) disclaim the lease, or (b) retain the lease for all or any portion of the remainder of the term, upon the terms and conditions set out in the lease. If the trustee elects to retain the lease, then, provided that it pays to the landlord all of the arrears of rent, the trustee may, pursuant to s. 38(2) of the CIA, "assign the lease with rights of renewal, if any, to any person who will covenant to observe and perform its terms and agree to conduct upon the demised premises a trade or business which is not reasonably of a more objectionable or hazardous nature than that which was thereon conducted by the [franchisee]..". The assignee must be approved by a judge of the Superior Court of Ontario to be "a fit and proper person to be put in possession of the leased premises".²³

In considering whether it should assign the lease, a trustee will need to be mindful of the use and trade name restrictions in the lease and consider whether the assignee will be able to comply with such restrictions. In the

²² R.S.C. 1985, c. B-3, s. 1 [am. 1992, c. 27, s. 2].

²³ See CTA, s. 38(2).

case *Micro Cooking Centres (Canada) Inc. (Trustee of) v. Cambridge Leaseholds Ltd.*,²⁴ the Ontario High Court considered a proposed assignment of a lease in a shopping centre for a use which was materially different from the use permitted in the lease. The court affirmed that the CIA overrode any restrictions contained in the lease relating to prohibitions on assignment. However, it went on to state that by the terms of the legislation, the assignee was specifically bound by all the terms of the lease including the use clause. The court held that the purpose of the statute is to place the “assignee in the same legal position vis-à-vis the landlord” as was the bankrupt tenant. Henry J. concluded that in determining whether the assignee was a fit and proper person to be put in possession of the premises, he was obligated to consider the unique business character of a shopping centre where the “interaction of each business with the others and with the mall operation as a whole” was vitally important. The application for approval of the assignee was denied. In this case, the “community of interest” Factor inherent with a shopping centre was the determining factor. In a 2001 decision of the Ontario Superior Court of Justice,²⁵ Spence J. dismissed a motion by the trustee of Dylex Ltd. seeking approval to assign 11 leases of Dylex’s BiWay division to Dollarama. In this case, the court noted that it could make a distinction between use clauses which govern types of activity and those that govern the identity of the tenant and made the following comment:

Obviously if the user clause was tantamount to a statement that “the premises can only be used by the tenant itself”, that would preclude any assignment on any basis and the whole point of s. 38(2) is to override restrictions on assignment. But s. 38(2) can be given reasonable effect without taking it to the point of overriding use provisions which do not require the identity of the tenant not to change.²⁶

Spence J. further noted that where a use clause is unduly restrictive for purposes of s. 38(2)...the court can make the necessary adjustment”.²⁷ Ultimately, the court did not approve the assignments because the proposed use by the assignee would constitute a change in use from the use clause in the applicable leases. With respect to trade name restrictions, the court may be more willing to allow assignees to change the trade name. In *Palate Yorkdale Inc. (Trustee of) v. Bramalea Centres Ltd.*,²⁸ Farley J. allowed an application for a declaration approving a proposed assignment of a lease by the trustee for Palate Yorkdale Inc. to a numbered company owned by the owner of “Benix” store. The landlord objected to the proposed assignment primarily because “Benix” was known in the industry as a downscale discounter which they believed would not be compatible with Yorkdale’s retail mix and image and also because the assignee could not obtain a license to use the trademark “The Palate” and the lease contained a trade name restriction requiring the tenant to operate the premises under the trade name “The Palate”. The court dismissed the first point as the assignee agreed at the hearing that it would operate as an upscale non-discount store and that it would comply with the use clause. With respect to the trade name restriction, Farley J. stated:

I am of the view that this is such a case to look at what is material in the lease and to in effect ignore what is mere surplus window dressing. There is nothing in the material before me which could lead me to the conclusion that the landlord had been persuaded that PY [the bankrupt] was a suitable tenant by reason of it having the then right to use the trademark.²⁹

He then continued by noting that “it would seem to me that what would be important to the landlord was that the business in the premises would be conducted under a name which was suitable for the nature of the

²⁴ (1988), 68 C.B.R. (N.S.) 60, 48 R.P.R. 32.

²⁵ *Richter & Partners Inc. v. Westwood Mall (Mississauga) Ltd.* (2001), 33 C.B.R. (4th) 292, 110 A.C.W.S. (3d) 418 (Ont. S.C.J. (Comm. List)).

²⁶ *Ibid.*, at para. 29.

²⁷ *Ibid.*, at para. 31.

²⁸ [1994 O.J. No. 2202 (QL), 50 A.C.W.S. (3d) 679 (Ont. Ct. (Gen. Div.)).

²⁹ *Ibid.*, at para. 13.

operations”.³⁰ These cases reveal that a court may not demand absolute strict compliance with the use and trade name restrictions in a lease by an assignee under s. 38(2) of the CTA, but it will expect substantial compliance with all material restrictions.

If the franchisor/tenant becomes bankrupt the position of the franchisee could be jeopardized. However, the CTA deals specifically with the rights of the subtenant of the premises in the event that a receiving order has been made in bankruptcy against the tenant. Section 39(2) of the CIA provides that if, prior to the bankruptcy, the tenant has sublet the premises with the approval or consent in writing of the landlord, the subtenant has the right to elect, within three months of the bankruptcy, to “stand in the same position with the landlord as though he were a direct lessee from the landlord but subject, except as to rental payable, to the same liabilities and obligations as the assignor, bankrupt or insolvent company was subject to under the lease ...”. If the subtenant makes this election, it will have to pay to the landlord as rent an amount not less than the sublet rent that was being paid to the tenant under the sublease. This right of the subtenant to lease directly from the landlord applies whether the trustee in bankruptcy elects to surrender possession of the premises, to disclaim the lease or to assign the lease. Of note, the *Civil Code of Quebec* has no corresponding terms in the case of bankruptcy, such that typically the lease terms will prevail, which in most cases will provide for termination rights,

Two interesting questions arise from the rights granted to the subtenant pursuant to s. 39(2) of the CTA. First, the rights of the subtenant pursuant to s. 39(2) of the CTA are only available if the landlord has approved or consented in writing to the sublease. The franchisor/tenant may, however, have been successful in negotiating with the landlord the right to sublease the premises to a franchisee, without requiring the landlord’s consent. Could the landlord, therefore, argue that since the franchisee/subtenant was not approved in writing by it, the subtenant should not be entitled to obtain a direct lease with the landlord under s. 39(2) of the CTA? In the case *Majdpour v. M & B Acquisition Corp.*,³¹ the Ontario Court of Appeal held that the words “in writing” only modified the word “consent” and that a landlord’s approval does not necessarily need to be in writing. In reaching this conclusion the court noted the following:

- (1) the word “approved” would be meaningless if the words “in writing” modified both “approved” and “consent”;
- (2) the main purpose of s. 39(2) of the CTA is to protect subtenants and this purpose would not be served if the subtenants could only invoke this section if it could in each instance, produce a written consent from the landlord; and
- (3) approval may be implied by the landlord’s conduct or by virtue of the fact that its consent was not required for the sublease.

A second question raised by s. 39(2) of the CIA relates to the right of the subtenant to a direct lease with the landlord if the trustee in bankruptcy elects to assign the lease. What would be the rights of the subtenant vis-à-vis the assignee? There does not appear to be any case law in Canada on this point. There is, however, an argument that perhaps the trustee would be required to assign the lease to the franchisee/subtenant on terms and conditions which the trustee is prepared to assign the lease (and on which other third parties are prepared to accept an assignment).

b. Bankruptcy of the Franchisee

Franchisee as Tenant

If the franchisee has entered into a lease directly with the landlord and then becomes bankrupt, the rights of the parties are less complicated. The trustee in bankruptcy of the franchisee would have the right to remain in

³⁰ *Ibid.*, at para. 14.

³¹ (2001), 206 D.L.R. (4th) 627, 56 O.R. (3d) 481 (C.A.), aff’d 25 C.B.R. (4th) 62, 43 R.P.R. (3d) 312 (Ont. S.C.J. (Comm. List)).

possession of the premises for three months and elect to either disclaim the lease or retain it and, at its option, assign the lease in accordance with the limitations set out in s. 38(2) of the CIA. Assuming that the franchisor is willing to assume the lease obligations, or can find a qualified franchisee willing to assume those obligations, and further assuming that the trustee in bankruptcy is willing to assign the lease to the franchisor or to its new franchisee, then the outlet can continue to be operated within the franchise system, despite any wishes of the landlord to the contrary.

Franchisee as Subtenant

As set out above, leases generally include a provision permitting the landlord to terminate the lease upon the bankruptcy of a tenant or occupant of leased premises. However, such clauses are not enforceable as against a trustee in bankruptcy of a subtenant or occupant because of the provisions of s. 1(e) and s. 38(2) of the CIA. Section 1(e) of the CIA defines “tenant” as including both an occupant and a subtenant, and as mentioned above. s. 38(2) entitles the trustee in bankruptcy to occupy the premises for a period of three months following the effective date of the bankruptcy, during which time the trustee could either disclaim the lease and surrender possession of the premises or elect in writing to retain the premises for the whole or any portion of the unexpired term of the lease and the renewable period.

An interesting situation could arise in the franchise setting if the franchisee as subtenant becomes bankrupt. If the franchisee’s trustee chose to assign the sublease pursuant to s. 38(2) of the CIA, could the trustee also assign the franchise agreement? There is certainly no right to do so conferred by s. 38(2). If the answer is “no”, then the franchisor would wind up with a subtenant who is not his or her franchisee. However, the sublease being assigned would probably require the subtenant to carry on business using the system trademarks. Clearly, the new subtenant would not be entitled to use these trademarks without first being qualified as a franchisee and signing a franchise agreement. From a practical point of view, no one in these circumstances should take an assignment of the sublease unless an assignment of the franchise agreement is also obtained. Thus, the rights of the trustee in bankruptcy under s. 38(2) of the CIA are circumscribed by practical realities, unless the court would be willing to find that, because of the nature of the franchise relationship, the franchise agreement and the sublease are inextricably tied to each other, with the result that s. 38(2) applied to both. By necessary implication, the court would be finding that as a matter of public policy, s. 38(2) must override the contractual rights of the franchisor under the assignment and termination provisions of the franchise agreement. The foregoing sets out the strict rights of the parties; however, the landlord often requires in a sublease or its consent to sublease, that the subtenant franchisee waives any rights it may have under the CTA or the BIA to elect to retain the unexpired term of the lease or to enter into any direct lease with the landlord in the event of the bankruptcy or insolvency of the tenant/franchisor.

Section 39(3) of the CIA provides that “in the event of any dispute arising under this section or section 38, the dispute shall be disposed of by a judge of the Superior Court of Justice upon an application”. This provision recognizes the intricacies and difficulties involved in the bankruptcy situation and provides for a manner in which disputes can be readily settled.

VI. CONCLUSION

When embarking upon a franchise relationship, the franchisor and franchisee (and if applicable, the third party owner) must determine how they will structure the real estate aspects of their relationship. There are several key factors which play a role in this decision, including: (i) the desirability of the location; (ii) who owns the premises; (iii) the bargaining strength of the franchisor, franchisee and third-party owner (if applicable); and (iv) the unique interests and concerns of each party. This paper highlights their respective concerns, as well as the options available to them and some suggestions on how to protect their interests when structuring this relationship.

SAMPLE CLAUSES

The following sample clauses (and those included earlier in this paper) are intended only as examples. As with all such examples and precedents, they are not appropriate in all circumstances and they should not be relied on as precedent material without first carefully considering the relative bargaining power of the parties involved and the intention of your client.

Sample Clause 1 (Permitted Transfers contained in a Franchisor's Lease)

Caveat: The following clauses were heavily negotiated between a franchisor and a major developer with considerable bargaining power on the developer's lease form.

Section B Assignment

Notwithstanding anything to the contrary contained in this Article, so long as the Tenant is ●, or a Permitted Transferee, (which for the purpose of this Article B shall mean those transfers contemplated in paragraphs (a), (b) and (c) below) and provided Tenant is not in Material Default, beyond the cure period provided in the Lease, then Tenant may assign the Lease or sublet the Premises pursuant to the terms of this Lease without the prior written consent of Landlord. Further, Tenant may assign the Lease or sublet the Premises without Landlord's prior consent to:

- (b) the parent, affiliate, associate or subsidiary corporation of the Tenant, as such terms are defined in the *Canada Business Corporation Act*;
- (c) a corporation formed by Tenant and another(s) as a result of a merger or amalgamation; or
- (d) a corporation simultaneously purchasing all or substantially all of Tenant's restaurants in Canada operating under the same business style and name as the Premises.

Section C Sublease to Franchisee

Notwithstanding the foregoing provisions of this Article, Tenant will be permitted to sublease the whole of the Premises to a bona fide franchisee of Tenant (the "Franchisee") without the Landlord's consent, provided that Tenant is not in default of any of its obligations or agreements in this Lease, beyond the period of time provided herein to cure such default, and provided further, that such sublease will only become effective upon Tenant having provided to Landlord all of the following:

- (i) any outstanding lease document (which said document is amending the Lease in manner that has previously been discussed and the terms have been negotiated between both Landlord and Tenant) in respect of the Premises executed by Tenant in a form satisfactory to Landlord;
- (ii) duly executed copy of such sublease;
- (iii) the covenants of Franchisee directly with Landlord and in form satisfactory to Landlord that the Franchisee will use the Premises for the use set out in this lease, will operate Tenant's business carried on at the Premises under the same name and style of Tenant as set out in Article ● of this Lease under the supervision of Tenant, will perform each and every of the terms, conditions and covenants of this Lease to be performed on the part of Tenant and that any breach of this Lease by Franchisee will constitute a breach of the said franchise agreement; and
- (iv) if the Franchisee is in default under the Lease and has not cured such default in the time permitted under this Lease, Tenant covenants with the Landlord to rectify such default by paying any Rent owing under the Lease on behalf of the Franchisee.

Provided, however, that such sublease will be deemed to have been revoked or rescinded upon the day immediately preceding the day upon which any such Franchisee ceases to retain such status to Tenant and, in the event, Tenant, itself or by way of an alternate Franchisee, will resume possession of the Premises and will operate the business required to be carried on in the Premises in accordance with all of the provisions of the Lease.

Tenant acknowledges that it will be responsible for the payment of the fees charged by Landlord, which are set out herein, for the preparation and/or execution of any documentation related to the foregoing, except with respect to the first subtenant, however Landlord will be permitted to charge this fee for all other transfers.

Section D Assignment to Franchisee

In the event that this Lease is assigned to a franchisee (“Assignee”), the provisions of this Article will be deemed to be a part of the assigned lease and • (the “Franchisor”) will become a party to the assigned lease solely for the purposes of enforcing its rights as out in this Article.

1. The Landlord acknowledges that:
 - (a) the Assignee is to operate its business on, in and from the Premises pursuant to a franchise or license agreement (the “Franchise Agreement”) entered into between the Franchisor and the Assignee;
 - (b) the Franchise Agreement provides that the Franchisor is to be satisfied with the terms of the Lease, that the execution of the Lease by the Franchisor constitutes its approval as to the form and content thereof, and that such approval, together with the payment of • dollars by the Franchisor, the receipt and sufficiency of which is hereby acknowledged by the Landlord, will be good and sufficient consideration for the granting by the Landlord in favour of the Franchisor of the rights set out in this Article;
 - (c) notwithstanding the execution by the Franchisor of the assigned lease for the purposes set out in clause (b) and for the purpose of enforcing the rights under this Article, no liability will accrue to the Franchisor under the assigned lease unless and until it will covenant with the Landlord to undertake or assume such liability; and
 - (d) the Franchise Agreement provides that Franchisor may, in the event of the Assignee’s failure to do so, enter on the Premises and correct any default of the Assignee under the Lease.
2. The Landlord covenants to give notice in writing to Franchisor of any default of the Assignee under the Lease and Franchisor will be provided the length of time accorded to the Tenant under the Lease within which the Tenant is obligated to remedy any such default, plus five (5) business days, within which Franchisor may itself correct such default.
3. Should the Landlord elect to cancel or terminate the Lease by reason of any breach or default of the Assignee in compliance with the terms of the Lease, the Landlord will give notice in writing to Franchisor of its intention to cancel or terminate the Lease. In the event of such cancellation or termination and provided that Franchisor has corrected or remedied or agrees to correct or remedy any default or breach of the Assignee within twenty (20) days following such cancellation or termination, Franchisor will be entitled to a lease in its name for the unexpired balance of the term of the Lease, plus renewals, on the same terms and conditions as set forth in the Lease.
4. Franchisor will have the right to call for any assignment of the Lease to Franchisor or, as directed by Franchisor, to a franchisee or licensee of Franchisor (as specified by Franchisor), or at the Landlord’s option, for a new lease on the same terms and conditions as contained in the Lease, for the unexpired portion of the term, plus renewals, upon producing to the Landlord a certificate from Franchisor under its corporate seal to the effect that the Assignee has defaulted under the Franchise Agreement and that Franchisor is entitled to call for such assigned or new lease. The Landlord agrees to consent to such assignment or to issue a new lease without regard to any claims of the Assignee and any dispute between the Assignee and Franchisor will be dealt with as between themselves. In the event of an assignment of the Lease to Franchisor, Franchisor covenants to be bound by all the terms and conditions of the Lease in the same manner as if Franchisor were the original Tenant hereunder.

5. The Assignee may assign the assigned lease to Franchisor or to a franchisee of Franchisor at any time, provided that the Assignee's covenants continue in full force and effect.
6. The Landlord acknowledges that Franchisor has certain copyright and trademark rights in respect of certain design features, plans, layouts, colour schemes and logos regarding the restaurant installed and operated in the Premises and that, on the expiry of the term of the Lease (or renewal term), the Premises must be altered such that any business to be carried on in the Premises thereafter will not appear to the public to be carried on by Franchisor or a franchisee of Franchisor or infringe any copyright or trademark rights of Franchisor. If the Assignee should continue to use the Premises as a restaurant in respect of which Franchisor has any copyright or trademark rights, and the Assignee does not effect such alterations hereinbefore mentioned, Franchisor will be entitled, for a period of thirty (30) days thereafter and for such period Franchisor will pay all Rent and other charges payable as if it were overholding.

Notwithstanding anything to the contrary contained herein, before the Landlord enters into a Lease with Franchisor for the remainder of the Term of the Lease pursuant to any default under the Lease as set out above, all monies owing under the Lease must first be paid in full.

Section E Permitted Transfers

For the purposes of this Lease, any Transfer effected in accordance with B, C or D or individually or collectively referred to as "Permitted Transfer(s)".

Sample Clause 2 (Permitted Transfers contained in a Franchisee's Lease)

Caveat: The following clauses were heavily negotiated between a franchisee and a major developer with considerable bargaining power on the developer's lease form.

Section A

Notwithstanding anything contained in this Lease to the contrary, the Tenant shall have the right, without the prior written consent of the Landlord, but upon prior written notice to the Landlord, to assign the Lease to the following (hereinafter referred to as the "Permitted Transferee(s)"):

- (i) a bona fide duly qualified franchisee of the Franchisor (the "Permitted Franchisee"), subject to the conditions of Section B hereof, and
- (ii) the Franchisor,

provided that: (i) the Tenant shall remain fully liable under the terms of this Lease to the Landlord and shall not be released from performing any of its terms, covenants and conditions, including the payment of Rent; and (ii) the Permitted Transferee carries on the same business set out in Section __ herein. For greater certainty, none of Sections __ to __ inclusive shall apply in the case of a Transfer to a Permitted Transferee.

Section B

In the event of an assignment of this Lease to a Permitted Franchisee of the Tenant pursuant to Section A of this Lease, the following shall apply. Further, the Permitted Transfer to a Permitted Franchisee is a provision in favour of the Tenant identified in this Lease only, and shall not apply to the Permitted Franchisee:

- (a) such Permitted Franchisee shall be subject to the terms, covenants and conditions contained in this Lease;
- (b) such Permitted Franchisee shall not at any time occupy less than the whole of the Demised Premises;
- (c) such Permitted Franchisee shall carry on business under the trade name and style of the Franchisor and in such manner so that to all intents and purposes, such business shall appear to the public an integral part of the Franchisor's business operations;

(d) the Tenant shall provide the Landlord with an executed copy of the franchise agreement for the Permitted Franchisee and if any terms, covenants or conditions contained in the Tenant's franchise agreement are in conflict or inconsistent with the terms, covenants and conditions contained in this Lease, the terms, covenants and conditions of this Lease will prevail;

(e) any such Permitted Transfer by the Tenant shall not operate to discharge the Tenant from liability under this Lease and the Tenant shall remain liable for a full and complete performance of all terms, conditions, covenants and agreements therein contained;

(f) the Landlord, in its sole discretion, must be satisfied as to the creditworthiness and financial position of the Permitted Franchisee (in this regard, the Tenant shall provide the Landlord with financial and other information as the Landlord may require in order to make such determination);
and

(g) this Lease is in good standing.

Sample Clause 3 (Franchisor's Right to Cure the Franchisee's Default & Assume Lease which may be inserted into a Franchisee's Lease)

The Tenant warrants and represents that it is a franchisee under a franchise agreement with • (the "Franchisor"). Upon default by the Tenant, (a) the Landlord shall give the Franchisor written notice simultaneously with delivery of notice to the Tenant, and the Franchisor shall have the right, at its option, to cure such default within the period(s) provided under Section ___ of this Lease, and (b) if the Tenant, or the Franchisor, fails to cure such default within the period(s) set out in Section ___ herein, and before proceeding with any other rights or remedies available to the Landlord against the Tenant, the Landlord agrees to give further written notice to the Franchisor at such time as, pursuant to the Tenant's default, the Landlord elects to cancel or terminate this Lease (the "Notice of Termination"). In the event of such cancellation or termination and provided that (i) the Franchisor has corrected or remedied any default or breach of the Tenant (including, without limitation, payment of Rent arrears) within the time to remedy provided in such notice of cancellation or termination (not to be less than ten (10) days (or if the breach would reasonably take more than ten (10) days to remedy, commences remedying the breach within the ten (10) day period, and continues to diligently and expeditiously to complete the remedy) (the "Assumption Requirements"); and (ii) then the Franchisor shall be entitled to assume the Tenant's rights and obligations under this Lease for the unexpired balance of the Term, plus any options to extend the Term, on the same terms and conditions as set forth in this Lease, and the Tenant shall cease to have any further rights under this Lease. The Franchisor may exercise such right to assume this Lease by providing the Landlord with written notice within ten (10) business days of the Landlord's Notice of Termination, in which event the Franchisor shall take immediate possession of the Demised Premises, provided that the Franchisor has complied with the Assumption Requirements and, if required by the Landlord, has entered into an agreement to reflect the assumption by the Franchisor. In the event of such assumption, the Franchisor shall be entitled to Transfer this Lease to a Permitted Franchisee, provided that such Transfer complies with the terms of Section ___ of this Lease.

The Tenant hereby acknowledges and agrees that if this Lease is terminated or cancelled following an Event of Default which is not cured within the period(s) set out in Section ___, the Tenant shall be deemed to have (i) automatically surrendered the Demised Premises and the Lease and all of the Tenant's rights, estate, and interest thereunder; and (ii) irrevocably waived and renounced its right to apply to any Court of competent jurisdiction for any form of relief from forfeiture and this provision shall be a complete defence to any claim made for relief from forfeiture or any like named by the Tenant. It is understood and agreed that the Tenant shall in no way interfere with the Franchisor's rights in this Section to assume the Lease as aforesaid.

Sample Clause 4 ("Conditional Assignment" Provisions)

(a) Notwithstanding anything in this Lease to the contrary, it is understood and agreed that if the franchise agreement made the ___ day of _____ (the "Franchise Agreement") between the Tenant and • (the "Franchisor") is terminated or cancelled for any reason whatsoever, the Tenant's rights under this Lease shall, at the option of the Franchisor, be transferred and assigned to it. The Franchisor may exercise the foregoing option by giving the Franchisor written notice within • days following the termination or cancellation of the Franchise Agreement, which notice shall specify, inter alia, the date of such termination or cancellation. The Tenant hereby

acknowledges and agrees that the Landlord may rely upon such notice and shall not be required to inquire into the due execution thereof or the accuracy of the statements set forth therein. It is further agreed that such notice shall, without further act or formality, operate as an effective assignment of the Tenant's rights and interest hereunder to the Franchisor and the assumption by the Franchisor of the covenants herein required to be observed or performed by the Tenant. The Franchisor shall thereafter have the right to assign or sublet the Premises to such person or entity as it may designate provided that in such event the Franchisor shall remain primarily liable for the due performance of all obligations of the Tenant contained in this Lease. If the foregoing option is exercised as aforesaid, the Franchisor and the Landlord shall execute such further documentation as may be reasonably required by the other to give effect to the exercise of such option.

- (b) The Landlord shall deliver written notice to the Franchisor (simultaneously with the giving of such notice to the Tenant) of any default by the Tenant under this Lease and the Franchisor shall have, after the expiration of the applicable cure period(s) provided in Section ___ of this Lease; an additional • (•) days to cure, at its sole option, any such default, provided that if such default arises by reason of the bankruptcy or insolvency of the Tenant or the appointment of a receiver over the Tenant's assets or part thereof, the Franchisor shall have the right to assume this Lease upon payment of any arrears of rental to such date. In the event of any such assumption, the Tenant shall cease to have any further rights hereunder.
- (c) The Tenant hereby agrees that the Landlord may upon the written request of the Franchisor, disclose to the Franchisor all reports, information or data in the Landlord's possession respecting sales made in, upon or from the Premises.
- (d) The Landlord hereby acknowledges and agrees that the Franchise Agreement contains a right on the part of the Franchisor, in the event of the termination of the Franchise Agreement for any reason whatsoever, to enter the Premises and to operate the business of the Tenant for the account of the Tenant for a period as set out in the Franchise Agreement. The Landlord further acknowledges that such entry and operation by the Franchisor shall not constitute an assignment of this Lease, nor a sublease the Premises hereby demised.
- (e) The Landlord acknowledges that the Franchisor is executing this Lease solely for the purpose of acknowledging the provisions contained in the foregoing clauses (a) to (d) and agrees that such execution by the Franchisor shall in no way obligate the Franchisor to perform any of the terms, conditions, obligations and covenants contained herein, except as specifically set forth in subparagraph (a).

Sample Clause 5 (Owner's restrictions on a Franchisor's Rights to Sublease to a Franchisee in an Offer to Lease)

Notwithstanding anything herein to the contrary, provided the Lease has been fully executed by the Landlord and the Tenant and so long as the Tenant is • [insert Franchisor's corporate name] and the Tenant is not (and has not been) in default under the Lease made pursuant to this Offer, the Tenant may sublease the whole of the Premises to a bona fide franchisee of • (a "Permitted Franchisee") without the Landlord's consent but upon prior written notice, provided that: (i) the Tenant gives prior written notice of such sublease to the Landlord and certifies in such notice that the Permitted Franchisee is a bona franchisee; (ii) the Permitted Franchisee will operate the franchised business permitted to be operated in the Leased Premises under the franchised trade name required by this Offer, the Lease and the Franchise Agreement and under the direct supervision and control of the Tenant, and otherwise in accordance with all of the provisions of the Lease; (iii) the Tenant has provided the Landlord with a duly executed copy of the sublease in a form satisfactory to the Landlord acting reasonably; (iv) the Permitted Franchisee covenants directly with the Landlord to be bound by the Lease and to observe and perform each of the covenants and obligations referred to in this Offer and the Lease; (v) the Tenant delivers to the Landlord a copy of the franchise agreement executed by the Tenant and the Permitted Franchisee; and (vi) if the Permitted Franchisee ceases to be a party to a franchise agreement with the Tenant or such franchise agreement is no longer in full force and effect, then the Tenant shall promptly resume possession of the Leased Premises and shall directly operate the business required to be carried on in the Leased Premises in accordance with all of the provisions of the Lease. No sublease to a Permitted Franchisee shall release the Tenant from its obligations, performance of the terms, covenants and conditions in this Offer and the Lease which are to be performed on its part.

Sample Clause 6 (Owner’s restrictions on a Franchisor’s right to transfer to a Franchisee in a Lease)

Notwithstanding anything to the contrary contained in Section __, so long as the Tenant is ●, the Tenant may sublease the whole of the Leased Premises to a bona fide franchisee of ● (the “Permitted Franchisee”) without the consent of the Landlord provided: (A) the Tenant is not in default of any of its obligations or agreements in this Lease; (B) the Tenant gives prior written notice of such sublease to the Landlord and certifies in writing that the Permitted Franchisee is a bona fide franchisee; (C) prior to any such sublease the Tenant shall furnish to the Landlord satisfactory evidence that there exists between the Tenant and the Permitted Franchisee a valid and subsisting franchise agreement to carry on the use set out in Section ● hereof; (D) the Tenant has provided the Landlord with a duly executed copy of the sublease in a form satisfactory to the Landlord; (E) the Permitted Franchisee shall operate the business permitted to be operated in the Leased Premises under the trade name “●” and under the direct supervision and control of the Tenant, and otherwise in accordance with all of the provisions of this Lease; (F) upon request, the Permitted Franchisee shall agree in writing with the Landlord to assume and perform each of the covenants and obligations of the Tenant in this Lease; (G) if the Permitted Franchisee ceases to be a party to a franchise agreement with the Tenant or such franchise agreement is no longer in full force and effect, then the Tenant shall notify the Landlord in writing of same and the Tenant shall promptly resume possession of the Leased Premises and shall directly operate the business required to be carried on in the Leased Premises; and (H) the Tenant and the Permitted Franchisee shall have first entered into an agreement directly with the Landlord (in a form satisfactory to the Landlord acting reasonably) which provides that if the franchise agreement between the Tenant and the Permitted Franchisee ceases to exist, such sublease and the Leased Premises shall automatically be surrendered to the Tenant and the Permitted Franchisee further agrees that it waives any rights it may have under any legal or equitable rule of law or under the *Commercial Tenancies Act* (Ontario), as amended from time to time, or any other applicable legislation, to apply to a Court or to otherwise elect to (i) retain the expired term of the sublease or this Lease; (ii) obtain any right to enter into any lease or other agreement directly with the Landlord for the Leased Premises, in any case where the Lease is terminated, surrendered or otherwise cancelled including, without limitation, a disclaimer of the Lease by a trustee in bankruptcy of the Tenant, or any repudiation of this Lease by the Tenant pursuant to bankruptcy legislation. Notwithstanding such sublease to a Permitted Franchisee, the Tenant shall remain fully liable under this Lease and shall not be released from its obligations under this Lease.

Sample Clause 7 (Owner’s restrictions on a Franchisor’s right to transfer to a Franchisee in a Lease)

Tenant shall not permit any business to be operated in or from the Premises by a franchisee without the prior written consent of Landlord, which consent may not be unreasonably withheld. The consent by Landlord to any franchise shall not constitute a waiver of the necessity for such consent to any subsequent franchise. If Landlord agrees to consent to any franchise to a franchisee (hereinafter a “Permitted Franchisee”), such consent shall only be given upon and subject to the following conditions:

- (i) neither the Lease nor Tenant’s rights, title and interest to same shall be assigned to the Permitted Franchisee;
- (ii) such franchise shall be subject to the terms, obligations and conditions contained in this Lease and the Permitted Franchisee shall agree in writing with Landlord to be bound by all the terms and conditions of this Lease and to fulfill, jointly and severally with Tenant, all Tenant’s obligations in accordance with this Lease;
- (iii) each Permitted Franchisee shall carry on business under the trade name and style of Tenant and in such manner so that to all intents and purposes, same shall appear to the public as an integral part of Tenant’s business operations;
- (iv) Tenant shall provide Landlord with a copy of each such franchise agreement prior to its execution and Landlord shall have the right to approve the terms of such agreement or to request changes to such agreement which Tenant shall make or cause to have made prior to Landlord granting its consent;
- (v) Tenant shall, and shall cause any Permitted Franchisee to, execute any document or instrument which Landlord reasonably requires, including, without limitation, a sublease of the Premises in a form prepared by Landlord at Tenant’s expense; and
- (vi) Landlord’s consent to such franchise and the Permitted Transferee will apply only and for so long as Tenant any such Permitted Franchisee are parties to the franchise agreement and the franchise agreement is in full force and effect with no default on the part of the Permitted Franchisee.

Sample Clause 8 (Owner's restrictions on a Franchisor's right to transfer to a Franchisee in a Lease)

Notwithstanding anything in Section __ to the contrary, but subject to Section __, if the Tenant is (i) ● and the Tenant continuously occupies the whole of the Leased Premises, and (ii) is not and has not been in material default of any of its covenants, obligations or agreements under this Lease which default has not been cured within the applicable cure period, the Landlord agrees that the Tenant may, without the Landlord's consent but upon forty (40) days notice in writing, and subject to the restrictions on Transfers contained in the Head Lease, sublet the whole of the Leased Premises to: (A) a subsidiary, parent or affiliated corporation of the Tenant (within the meaning of the *Business Corporation Act of Ontario*); or (B) a bona fide franchisee of ● (a "Permitted Franchisee"), who will operate the business permitted to be operated in the Leased Premises under the trade name required by this Lease and under the direct supervision and control of the Tenant; and otherwise in accordance with all of the provisions of this Lease.

Provided that no such sublease shall become effective unless and until:

- (i) the Tenant has provided the Landlord with a duly executed copy of the sublease in a form satisfactory to the Landlord acting reasonably;
- (ii) such sublease by its terms provides that all of the covenants and obligations of the Tenant under this Lease (other than the provision relating to payment of Rent to the Landlord) shall apply to the subtenant and the subtenancy;
- (iii) the subtenant covenants directly with the Landlord to observe and perform each of the covenants and obligations referred to in (ii) above; and
- (iv) the Tenant delivers to the Landlord a certificate, duly signed and sworn by two of its officers, certifying that the proposed subtenant is a subsidiary, parent, affiliated corporation or Permitted Franchisee, as the case may be.

Provided and it is a condition of the inclusion of this Section __, that any such permitted sublease shall automatically be deemed to have been revoked or rescinded upon the day immediately preceding the day upon which any such permitted sublessee ceases to retain such status (such as the day upon which the Permitted Franchisee is no longer a party to a franchise agreement with ● or such franchise agreement is no longer in full force and effect) and in that event the Tenant shall resume possession of the Leased Premises and shall directly operate the business required to be carried on in the Leased Premises in accordance with all of the provisions of this Lease.

The Tenant acknowledges and agrees that any breach by a Permitted Franchisee under its franchise agreement will constitute a breach of this Lease.

SAMPLE - ADDENDUM TO LEASE

_____, 20__

TO: _____ and its successors and assigns (“Franchisor”)

RE: Addendum to a lease made between _____ (“Landlord”) and _____ (“Tenant”) for the Leased Premises (as hereinafter defined)

WHEREAS:

- A. Landlord and Tenant entered into a Lease Agreement dated _____, 20__ (the “Lease”) pertaining to the real property located at _____ as is more particularly described on Exhibit A, attached hereto (the “Leased Premises”) allowing for operation of a _____ store; and
- B. Landlord and Tenant desire to incorporate the following terms into the body of the Lease.

NOW, THEREFORE, in consideration of the covenants herein and therein, the parties hereto agree as follows:

1. Notwithstanding anything contained elsewhere in the Lease to the contrary, Tenant may use the Leased Premises for the purpose of conducting thereon the business of a _____ store and for incidental purposes related thereto.
2. In the event the Franchise Agreement dated _____, 200_ between Franchisor, as franchisor, and Tenant, as franchisee, is terminated or expires prior to expiration of the Lease, Franchisor shall have the right but not the obligation, to assume those rights and obligations of Tenant under the Lease coming due on or after the date Tenant vacates the Leased Premises, including taking possession of the Leased Premises, all fixtures, and leasehold improvements. Landlord shall give Franchisor written notice of Tenant’s vacation of the Leased Premises and thereafter Franchisor shall exercise such right to assume Tenant’s rights and obligations by written notice to Landlord mailed or delivered not later than fifteen (15) days after Franchisor’s receipt of written notice from Landlord of Tenant’s vacation of the Leased Premises.
3. Landlord hereby grants Tenant the unrestricted right during the initial term and any renewal or extension term of the Lease to assign the Lease or sublet the Leased Premises (of any part thereof) to Franchisor, without Landlord’s consent but upon written notice to Landlord. In such event, Franchisor shall be entitled to take possession of the Leased Premises for the remainder of the Term, upon the terms, covenants and conditions in the Lease, including, without limitation, Tenant’s rights to further assign the Lease or sublease the Leased Premises in accordance with the transfer provisions set out in the Lease, subject to the following paragraph. If the Lease is assigned to Franchisor, it is agreed that Franchisor shall be liable for the fulfilment of all of Tenant’s obligations under the Lease during the period between the date on which the Lease is effectively assigned to Franchisor and the date on which the Lease is assigned to another bona fide franchisee of Franchisor.

Notwithstanding anything in the Lease or this Addendum to the contrary, Landlord agrees that: (i) Franchisee/Tenant may, without Landlord’s consent but upon written notice, assign the Lease and its interest in the Leased Premises to Franchisor, provided that until Franchisor assigns the Lease to another franchisee, Franchisor agrees to be bound by all of the terms, covenants and conditions contained in the Lease pertaining to Tenant; (ii) at any time after the Lease is assigned to Franchisor, it may, without Landlord’s consent, but upon written notice, sublet all or a portion of the Leased Premises to a bona fide franchisee of Franchisor provided Franchisor agrees to be bound by all of the terms, covenants and conditions in the Lease pertaining to Tenant for the balance of the term of the Lease as if Franchisor had originally executed the Lease as Tenant; and (iii) at any time after the Lease is assigned to Franchisor, it may, without Landlord’s consent but upon written notice, assign the Lease to a bona fide franchisee of Franchisor provided such franchisee agrees to be bound by all of the terms, covenants and conditions contained in the Lease as if the new franchisee had originally executed the Lease as Tenant, and thereupon Franchisor shall be freed and relieved of all liability with respect to such covenants and obligations contained in the Lease. It is understood and agreed that an assignment by the original Tenant to Franchisor or an assignment by Franchisor to another franchisee described above shall not relieve the

original Tenant from the performance of the terms, covenants and conditions contained herein on its part to be observed and performed and the original Tenant shall remain primarily liable under the Lease after any such assignment.

4. Landlord shall give Franchisor a copy of any and all notices of default given to Tenant, as required, to be given by Landlord to Tenant under the terms of the Lease, at the same time such notice is given to Tenant. Within ten (10) days after Tenant's right to cure expires, Franchisor shall have the right, but not the obligations, to cure any such default. If any such default would reasonably require more than ten (10) days to rectify, such default shall be rectified if Franchisor commences rectification within the aforesaid ten (10) day notice period and thereafter diligently proceeds with rectification of the breach.

5. Upon the expiration or earlier termination of the Lease for any reason, Tenant, shall, upon written demand of Franchisor, remove all _____ trademarks from all buildings, signs, fixtures and furnishings, and alter and paint all buildings and other improvements maintained pursuant to the Lease a design and color which is basically different from _____ authorized building design and painting schedule. If Tenant shall fail to make or cause to be made any such removal, alteration or repainting within thirty (30) days after written notice, Landlord shall give Franchisor written notice of such failure and Franchisor shall have the right to enter upon the Leased Premises, without being deemed guilty of trespass or any other tort, and make or cause to be made such removal, alterations and repainting at the reasonable expense of Tenant, which expense Tenant shall pay Franchisor on demand.

6. Franchisee hereby covenants and agrees with Franchisor that throughout the Term of the Lease (and any renewal or extension thereof) it will not surrender, cancel, terminate or replace the Lease and it will not amend the Lease in any manner, without first obtaining Franchisor's prior written approval.

7. Notwithstanding anything to the contrary elsewhere in the Lease or any addendum or amendment thereto, Landlord and Tenant agree that the terms and provisions set forth in this Addendum shall control and shall not be superseded, terminated or modified without the prior written consent of Franchisor, a third party beneficiary to the Lease, and this Addendum.

8. This Addendum shall enure to the benefit of Franchisor and shall be binding upon Landlord and Tenant and their respective successors and permitted assigns.

IN WITNESS WHEREOF, the parties have executed this Addendum this ____ day of _____, 20__.

LANDLORD:

By: _____

Its: _____

Date: _____

TENANT/FRANCHISEE:

By: _____

Its: _____

Date: _____

FRANCHISOR

By: _____

Its: _____

Date: _____

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