



Over the last few years there has been a rapid progression and increase of activity in the retail sector with the arrival of power centres and retailers of many stripes and colours. As never before, the competition amongst landlords and retailers is as fierce as ever. In the context of that competition, retailers need to carve out their territory, and landlords are required to accommodate such needs. The problem for landlords is that they may have several clients each trying to limit the competition around them and therefore the landlord's opportunities to lease space. Furthermore, landlords will have specific business models and mixes which they may see as being required to increase the values of their properties and therefore in most cases the attractiveness of the centres for tenants present and future.

Therein are the issues around the competitive nature of the retail leasing sector. Landlords have a tendency to want to restrict the use of the premises made by a tenant, while not limiting themselves to leasing other space to future tenants. The tenant however typically wants as little restriction as possible as to its use of the premises and would want to ensure that no competition exists as to its operations, within at least the centre itself.

In many cases the exercise of negotiating the so-called use clauses and exclusivity clauses are somewhat known entities with respect to landlords and retailers. In the context of negotiations, it will be important for the tenant to acknowledge and understand the dynamics the landlord may be facing as far as the use and exclusivity terms. Similar use locations will obviously create different issues than locations with a number of distinct, varied and often complementary tenants. Furthermore, in areas where the centre itself is promoting the sale of similar items, food courts, fashion centres, etc. the use and exclusivity provisions will become a significant element of the lease discussions.

On a practical note, and while not the focus of this article, it will be important that the issues of use and exclusivity be settled at a preliminary stage of discussions either through a letter of intent or offer to lease. *It would be recommended that these elements be discussed within the terms of a prior letter of intent or offer to lease, and not left to the lease negotiation.*

CONSIDERATIONS IN NEGOTIATION OF THE USE PROVISIONS

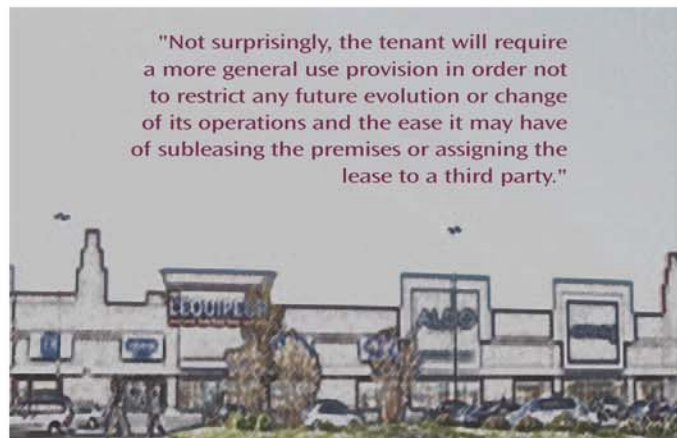
Not surprisingly, the tenant will require a more general use provision in order not to restrict any future evolution

or change of its operations and the ease it may have of subleasing the premises or assigning the lease to a third party. The basic premise for the tenant will be as follows:

- be as general as possible;
- do not limit the use to a particular brand name;
- have the opportunity to change the use with or without notice and subject to zoning or applicable law.

The landlord will in turn require more specifics as it typically needs to control its tenant mix of product and services in its centre. The landlord will also need to control any obligations with respect to other use or exclusivity provisions it may have agreed to. For the landlord the response will be:

- specific limits and terms as to nature or style of operation;



- specific terms as to nature of merchandise and services provided and sold;
- condition to use premises as to a particular brand name.

Where negotiations may finish will, like almost any other negotiation, depend on the relative strength of either the landlord or tenant. That being said and in presuming that both parties are more or less on an equal footing, the following is typically the result of a fairly negotiated use provision:

- a general description of the nature of the operations;
- specific examples of the nature of the merchandise and services to be provided;
- elements of principal and accessory merchandise or services;

- specific exclusions;
- the obligation to operate under a specific brand name but with the right to expand or change as to other brands subject to predetermined conditions;

- right to change use subject to landlord consent not to be unreasonably withheld or as may be settled, subject to landlord's sole discretion;

- list of specific exclusions as to use, often providing existing exclusions to present or future tenant as well as the landlord's intentions as to nature of centre, i.e. no bars, no bargain basement discount stores, etc.

The importance of the use provisions and difficulty associated thereto are a consequence of the relative specialisation of many retailers at the same time as many retailers have many concepts integrated in their operations. Both the tenant and landlord need to keep this in mind and have a good understanding of the business model they may be dealing with. As will be seen, should the provisions of the use clause be either imprecise or not cover the situation on hand, the parties will need to revert to the courts, which may not always provide the expected results. One only needs to look at the manner that retailers such as Wal-Mart and Club Price have expanded into areas, such as the sale of grocery products, whereas several years ago these areas may not have been considered as part of the mix.

Furthermore, when the nature of the centre, such as a fashion centre or food court, is to regroup a number of similar operations, the definition of what is acceptable and what may not be acceptable becomes crucial. *Properly drafted use and exclusivity clauses will establish rules which all parties can properly evaluate in order to determine both the value of the lease, its location and the expectations of profit.*

Lets look at the specific issue of food courts and the various types of operations. A restaurant can be many things:

- with or without seating;
- with or without table service;
- sale of drinks and notably alcohol;
- inclusion of coffees and teas;
- for on-site consumption or to be eaten off-site;
- will there be cooking or prepackaged meals i.e. sandwiches;

- general type or style of restaurant - i.e. family, pizza, sports, French, Italian, etc.

- limitations as to ancillary use such as for example coffee.

Consequently, when drafting both use and exclusivity provisions in the case of a restaurant, all of these elements would, to some extent, need to be considered.

EXCLUSIVITY PROVISIONS

Closely related to the issue of the drafting of use provisions, are the exclusivity provisions which are often negotiated in connection thereto. *It is important to note that for the tenant, the simple negotiation of a use provision will not mean that another tenant will be restricted from the same or a similar use in the centre.* While in practice a landlord, even without an exclusivity obligation, will typically work to protect its tenants and work on a mix where the tenants are complementary rather than in competition, as business evolves, a landlord may be more concerned with getting tenants into the centre above everything else. That being said, it is usually of interest

for a tenant to require such exclusivity wherever possible.

For the tenant, the following will be required:

- exclusivity as to nature of operation;
- exclusivity as to specific merchandise or service;

- territory related to centre and possibly adjacent property belonging to the landlord;

- restriction as to specific competitors.

For the landlord, the following will be the issues that will need to be considered:

- existing use and exclusivity provisions granted to other tenants;

- notice to future tenants as to exclusivity granted;

- limitation of territory and area of centre subject to such exclusivity;

- limitation of terms of exclusivity as to the nature of operations or style and specific products;

- term of exclusivity, notably initial term and any renewals;

- whether right of exclusivity is personal to tenant and can or cannot be assigned

with the lease.

There has been a considerable amount of litigation concerning the application of exclusivity provisions. Of note, certain cases have decided that when what has been set out in an exclusivity provision is a general reference to the style of the operation, it will be difficult for a tenant to contest the sale of any specific competitive merchandise or services, when in fact the competitor operates a different style of business.

The following are examples:

- an exclusivity was granted in favour of and as to a *donut shop style restaurant*. It was held that the operations of a *European style coffee shop* was not in



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contravention to the exclusivity granted. In practice, both locations sold many similar products. However, the court held that an easy distinction could be made between the two styles, which would easily differentiate the clientele which would frequent one or the other of the locations. Furthermore, as it is common that landlord and tenant will also include an exclusivity as to specific products, the courts found that as no specifics were provided, the intent of the parties must have been solely to limit the exclusivity to the style;

- the use provision in question provided for specifics as to the type of food product to be sold. However, the exclusivity provision only referred to a style and operation similar to that of the tenant. Again, the court held that the exclusivity which was to be protected was that related to the style and not the specific products even though such products were clearly and specifically indicated in the use provision. Again, this shows that a use provision is distinct from the exclusivity terms.

RESTRICTIVE USE SERVITUDES

In large part most exclusivity provisions are dealt with contractually under a lease, as a personal obligation owed by one party to another. In the past certain tenants have tried to establish the protection of the exclusivity not simply by the terms of a lease

and the personal obligations created therein, but by actually encumbering the land owned by the landlord by a servitude in favour of the tenant with a certain restriction in the use of the property.

In Quebec, the validity of such an arrangement has been subject to a certain amount of debate both in our case law and amongst legal commentators. The seminal case in this matter involved Steinbergs, perhaps the most important grocery operation in Quebec during its heyday before its demise several years ago now.

Steinbergs was also an important property owner. In an effort to limit competition, Steinbergs would systematically encumber land it owned, which in many respects was in prime locations, with restrictive use servitudes or encumbrances. To respect the terms of Quebec law, Steinbergs encumbered the land it owned and would ultimately sell to a third party, with a restriction not to use as a grocery store, in favour of the land which was its principal distribution facility in Montreal's east end. Because of the nature of the restrictive use, much of the debate centered on the issue of whether a servitude (at its essence the purpose of the servitude is to allow one property to benefit from another as for example to allow access) can be used for what is essentially a right which is not of a real nature but of a personal nature.

Several years ago now, the first case in this matter held that such a servitude was valid. However, subsequent cases over the years have found that such servitudes were in fact invalid and unenforceable. Finally in 2001, the Court of Appeal of Quebec seems to have put this issue to rest in finding that such a servitude is in fact unenforceable.

The facts in the case in question, *Metro Richelieu v. Standard Life*, were as follows:

- Standard Life provides a loan to Centre Commercial Victoriaville Ltée ("CCVL") to expand a commercial shopping centre, which is given as security for the loan;

- in the context of leasing a part of its property to Metro Richelieu, a grocery chain, and through a number of complex transactions and agreements, an arrangement is arrived at whereby CCVL granted a servitude against its property in favour of an adjacent lot owned by a third party. In the end Metro Richelieu leased such adjacent lot. The servitude provided a prohibition as to its use as a supermarket or grocery store. The servitude was to continue until either of, the Metro Richelieu lease expired, the closure for any reason of the Metro Richelieu store, or until the change of the use of the Metro Richelieu location;

- Standard Life exercised its hypothecary rights and became owner of the CCVL property, and therefore became owner of the property subject to the servitude wherein no grocery store could be operated;

- Standard Life takes action to have the servitude

declared null and unenforceable. Standard Life raised several arguments to contest the validity of the servitude notably that the terms of the servitude are not of a nature which can create a real right but rather a personal right which would not then be opposable to it.

In Superior Court, it was held that in effect the servitude only created a personal obligation which would be unopposable to Standard Life. Metro Richelieu proceeded to appeal the decision.

In appeal, the Court held that as the servitude was in effect tied to an event which was personal in nature, such as the operations of Metro Richelieu, and not fundamentally related to the real property itself, the servitude could not be valid.

The Court also reviewed other elements particular to Quebec Law known as personal servitudes which to a lesser extent could also have been held to be opposable to Standard Life as encumbering the property. The Court of Appeal also held that the conditions required for this had not been met.

In conclusion, the Court of Appeal held that the rights covered under the servitude were of a personal nature and therefore unopposable to Standard Life.

CONCLUSION

As in many provisions of the lease, the parties may have a tendency to take the use and exclusivity provisions of any lease for granted and not spend much time negotiating such terms. What both the tenant and landlord need to consider is how both respective businesses may evolve, as leases are typically entered into over the long term. These clauses should be negotiated at an early stage of discussions such as in a letter of intent or offer to lease. It is important to monitor existing terms of any use and exclusivity provisions and to immediately take action when it is found that either the use or exclusivity provisions are not being respected. •