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USING (OR ABUSING?) THE USE CLAUSE

At the heart of any successful shopping centre is a deliberate merchandising plan that maintains the right quality and variety of tenancies. One of the ways landlords control this balance is by way of lease provisions that prescribe each tenant's permitted use.

In light of the recent decision in *2249778 Ontario Inc. v. Smith (c.o.b. Fratburger)* ("Fratburger"), however, the ability of landlords to coordinate and execute their leasing plans may be compromised (with potentially drastic consequences for tenants too).

The Decision

In the Fratburger case, the landlord leased premises in a strip mall to a tenant for the operation of a "fast food restaurant". The use clause described the types of products that could be sold in the premises (hamburgers, hot dogs, etc.) and specified that, as ancillary to the primary use, a portion of the premises could be used for offices, but went on to stipulate that the premises were to be used **"for no other purpose"**.

The tenant installed an ATM on the premises. The landlord objected, arguing that the ATM fell outside of the tenant's use clause. When the tenant refused to remove the machine, the landlord applied to the Court for two things: a declaration that the lease did not permit an ATM on the premises, and an order requiring the tenant to remove it.

At trial, the Court found that the tenant's use of the ATM was for appropriate business reasons since it assisted the tenant in "keeping his costs low and his clients happy." The Court held that the ATM did not change the purpose of the premises as a fast food restaurant. As the Court put it, "[t]he primary focus of

the establishment and the attendance of its patrons, is for the consumption of food." The landlord appealed.

In upholding the trial Court's decision, the Ontario Court of Appeal observed that the lease did not define the meaning of a "fast food restaurant". Further, the Court noted that the lease was silent on other "critical" equipment such as cash registers and debit terminals, which the Court held were implicitly included in the permitted use of the premises. Since nothing in the lease specifically prohibited the installation of an ATM on the premises, the Court determined that the tenant should be entitled to have one.

Fratburger's Fallout

This decision came as a surprise to many in the commercial leasing industry. In holding that "it is open to parties to a commercial lease to specifically include the installation and operation of an ATM as a prohibited activity in the lease", the Court's decision opens the door to the argument that **unless** a particular use is explicitly **carved out** of a use clause, a tenant should be entitled to incorporate related or ancillary activities and uses in its business operations without the need to seek approval from the landlord.

The effect this approach will have on a landlord's ability to control the various uses of its tenants (and the merchandising mix of the shopping centre) is interesting, to say the least. Landlords may be wondering how they will implement leasing plans if they cannot predict the range of activities that will be part of each tenant's operations. Tenants also have



cause for concern. In a landscape where landlords cannot effectively control the activities conducted by their tenants, the protection afforded by an exclusive covenant may be compromised.

The Court's approach in *Fratburger* also raises contractual interpretation concerns. Basic principles of contractual interpretation seek to apply the intent of the parties at the time of the formation of the agreement. In doing so, courts will often refer to the plain and ordinary meaning of the words employed. The term "fast food restaurant" does not suggest that an ATM is necessary for the functioning of the business. In holding that the operation of an ATM should be included in the meaning of a "fast food restaurant", the Court implied an intention that does not seem to be supported by a plain reading of the lease terms.

The Court did try to limit the scope of this case by stating that "this case is confined to these parties and interpretation of this particular lease". Unfortunately this statement is somewhat gratuitous as all cases turn on their facts. Moreover, little guidance was provided regarding which facts led to the Court's conclusion. It may be that the Court felt the ATM was no more than another payment method, not unlike the use of a debit card. But would the Court have come to a different conclusion if there had been a bank tenant in the plaza with an exclusive on the operation of banking activities? Or, what if there

had been a neighbouring convenience store tenant with an ATM on its premises? Would the Court have taken into consideration the proximity of that ATM? The Court's lack of detail makes it hard to understand how the Court drew its conclusions.

Next Steps

If the Ontario Court of Appeal's decision in the *Fratburger* case reveals a judicial preference toward interpreting use clauses expansively, it might not be wise for landlords to merely delineate in the use clause the types of activities that are **permitted** on the premises. (It seems the limiting phrase that typically concludes most use clauses – "and for no other purposes" – is not to be relied on as a means of constraining and limiting a tenant's use of its premises.) Whereas tenants are naturally disposed towards a simple generic use clause (to allow flexibility in their business practices), landlords now have even greater reason to insist on a detailed description of both the scope of the tenant's **permitted and prohibited** activities. It remains to be seen whether this decision will result in a movement towards drafting use clauses as expansive lists of specific permitted and prohibited uses. What is certain, though, is that landlords and tenants alike are left in very murky waters when interpreting use clauses.



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