# Overview of the Leasing Process – Finland

## 1 Introductory remarks

1.1 **The importance of the fairly tiny Finland.** Located about half way between the traditionally important *Stockholm* in the West and the hive of industry of the vast *St Petersburg* region in the East, a Nordic welfare state with an active, well educated population [of 5.5 Million people], a balanced economy, a founding member of the Euro Area (the only one in the whole of Northern Europe!), Finland is a locomotive power, strong supporter of the weaker economies within the EU and a cornerstone of the Community presently, decisively recovering from the financial crunch.

1.2 **Franchising in Finland.** Presently, with a total of roughly 200 networks and about 7000 outlets counting for about 50 000 employees and an annual turn-over of EUR 5 Billion, and franchising steadily increasing, still franchising (and in particular Business Format Franchising) is less deployed than in some of the neighbouring countries, such as Sweden, Denmark and Estonia. — The reason may be found in, on one hand, the Finnish "the-loyal-servant" sentiment fomented by the big business promoting bureaucracy, still lingering in particular as to strict monthly reporting requirements and all but encouraging taxation, and on the other hand a latent reluctance to be kept in the franchisor´s tight leash.

Accordingly, the distribution of many an internationally well known brand, such as *H&M*, *Lindex, Seppälä*, etc. is organized, primarily or alone, by means of their own network of boutiques, shops and other outlets, and not by means of franchising. And in lieu of their own outlets, many brands, such as *Tempur* and *Nike*, seem to prefer selective distributors. However, in Finland, well known franchisors are, e.g., *AVIS, Bestseller* (*Jack & Jones, Vero Moda, O-n-l-y*), *Hertz, Holiday Inn, McDonalds* and *Subway*, but quite a number domestically originating, in particular in the service field, provide an eagerly growing offspring.

1.3 **The alternatives.** Where the franchisee operates from a fixed location, the premises of the franchisee — whether real estate (e.g., used for Gasoline Stations, Holiday Inn Hotels, drive-in Burger Restaurants, etc.) or business premises being part of a shopping mall, centre or other property, such as a boutique, restaurant, car rental business, etc:, — are, in general, either

[1] owned by a third party landlord (the size of which varies, from listed companies such as *CapMan*, *Aberdeen*, etc. to the smallest family owned property companies or individuals) who lets the premises either

[1.1] to the franchisee, directly, or

[1.2] to the franchisor [or a franchisor mandated master-franchisee] who on his part re-lets[1] the premises to franchisee, or

[2] owned by the franchisor who lets the premises to the franchisee.

1.4 **Identifying the intricacies/problems.** In particular, where the goodwill value of the location of the franchisee´s outlet is established, franchisor may wish to be able to make sure that the location will remain part of his franchise network, even if the franchisor/franchisee relationship ends. — How to obtain and maintain control over the location of the franchisee´s outlet?

First, only rarely does the franchisor own the premises leased by the franchisee; this is simply so because owning requires capital, and franchising is shifting investment obligations and risks to the franchisor (property and casualty risks; non deductible taxes): Right! — If the franchisor does not wish to invest in the business operated by the franchisee, why would he invest in the premises from which a franchised business is operated?

— And the same as above pertains to re-letting premises (sublease). This results in a long term liability; corresponding impact on borrowing capability; property and casualty risks (environmental & negligence) may decrease the willingness of a franchisee to pay royalties, marketing fees, etc.; nonpayment by franchisee/tenant exposes franchisor to unreimbursed payment obligations; creates disincentive to terminate for defaults because of financial burden of paying lease, thereby permitting substandard performance by tenant/franchisee; potential exposure to claims for breach of a fiduciary duty, or duty of good faith when lease is promoted as being acquired for the benefit of the franchisee; unless the parties have agreed to have any controversies finally dealt by arbitration, the franchisor may find himself ending up in an ordinary court[2]. Conclusion: To the franchisor, re-letting/subleasing is, generally, not a profitable venture.

But despite those above recognized and generally accepted drawbacks, in order to facilitate matters for the franchisee and, thereby, the sale of the franchise you may find the franchisor [or a franchisor mandated master-franchisee] either letting the premises he owns, or re-letting (subleasing) those he has leased, to his franchisee. Albeit financially risky and often burdensome, each of those alternatives provides the franchisor a strong control of the location. Here you have to pay attention to the fact that where the re-let of the premises is an integrated part of the franchise agreement and in practice it is merely about putting the premises to the disposal of the franchisee, the franchisor netting from

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1 Re-let (in Finnish: *edelleenvuokraus*) means that you let anew the whole object while sublease (or sublet; in Finnish: *alivuokraus*)) means that you let anew merely part of the house, suit, shop or whatever premises it is about.

2 Contrary to some other countries, in Finland a recognized fact is that all matters where a settlement between the parties is permitted can be dealt by an arbitral tribunal. Cf. *Gustaf Möller, Välimiesmenettelyn perusteet, Kauppakaari Oy 1997* pages 16 and 36.

the franchise and not the letting, you should be able to feel fairly safe not to get bogged down into the quagmire of having to apply the Act on Lease of Business Premises (1995/482). — Because most important case law remained unchallenged suggests that *the franchise agreem*ent *being a mingled type of an agreement, the Act on Lease of Business Premises cannot be applied to the franchise agreem*ent[3] (Helsinki Court of Appeal on 23 Dec. 1999, judgment No 3591 in case No S 98/1207). This opinion seems to rest on an almost two decades previously stated opinion by the Supreme Court (precedent KKO 1981-II-4) to the effect that a contract clause on the conveyance of real property being a Gas Station to the disposal of a "distributor" (however, in reality a franchisee) *did form merely part of the vast commercial agreement between the parties which was not to be severed from the contractual entirety by considering it as a separate contract on lease*[4]. About the same was confirmed by the Supreme Court in a precedent pertaining to a trade name and product distribution franchise arrangement (KKO 1981-II-143). The court took the view that a contract containing terms and conditions on commercial cooperation aiming at securing and promoting the sales efforts of the parties as well as on the putting at the disposal of the other party the business premises *constituted a solid contractual body* mainly dealing with other matters than the lease[5]. The result is that the parties, in accordance with European bearing principles, such as that of *freedom of contract*, *good faith* and *fair dealing*, shall be able to contract, validly, and regardless of those portions which are mandatory of the above mentioned otherwise optional Act on Lease of Business Premises.

Secondly, where the landlord being a third party lets the premises to the franchisee, directly, the financial burden is shifted to the franchisee but the problem remains that the franchisee is not much in control of the premises should the franchisor/franchisee relationship cease to exist. This situation poses

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3 In Finnish, quote: *"Hovioikeus toteaa, että kysymyksessä oleva franchising-sopimus on niin sanottu sekatyyppinen sopimus, johon ei voida Resta Sulevi Oy:n väittämällä tavalla lainkaan soveltaa liikehuoneiston vuokrauksesta annetun lain säännöksiä."*

4 In Finnish, quote: *"Sopimukseen tosin sisältyi myös yhtiön omistaman kiinteistön luovuttaminen A:n käyttöön sovittua vastiketta vastaan, jota kuitenkaan ei voitu pitää varsinaisena vuokrana vaan tietynlaisena käyttökorvauksena, mihin ilmeisesti sisältyi maksua muustakin kuin yksinomaan liikehuoneiston käyttöön saamisesta. Edellä tarkoitettu sopimuksen kohta muodosti vain osan asianosaisten laajasta kaupallisesta sopimuksesta eikä tätä osaa voitu erottaa sopimuskokonaisuudesta ja käsitellä erillisenä huoneenvuokrasopimuksena. Kun A:n kanteen perustana olevaa sopimusta ei edellä esitetyn mukaan voitu pitää huoneenvuokrasopimuksena eikä asianosaisten välistä oikeussuhdetta huoneenvuokralain mukaisena vuokrasuhteena, asunto-oikeus, jonka toimialaan kuuluivat ainoastaan huoneenvuokrasuhteista johtuvat riidat, ei ollut toimi valtainen käsittelemään A:n kannetta."*

5 In Finnish, quote: *"Sopimukseen sisältyvät osapuolten kaupallista yhteistyötä koskevat määräykset, jotka tähtäsivät asianosaisten markkinoinnin turvaamiseen ja edistämiseen sekä koskivat myös tässä tarkoituksessa tapahtunutta liikehuoneiston luovuttamista A:n käyttöön, muodostivat kiinteän kokonaisuuden. Kysymyksessä oleva riita-asia, vaikka siinä vaadittiin perusteettomasti perityksi väitetyn vuokran palauttamista, johtui näin ollen, sopimuksen tarkoitus ja kokonaissisältö huomioon ottaen, etupäässä muusta kuin huoneenvuokrasuhteesta."*

a real problem which probably most expediently can be solved by means of a conditional lease assignment between the landlord and the franchisee or some suchlike arrangement. However, the relationship between the landlord and the lessee/assignee is regulated by the Act on Lease of Business Premises whereby those of the rules of that act which are mandatory have to be complied with. However, having regard to the case law evolved and mentioned above[6], This In addition to the conditional lease assignment, other means on the palette of the franchisor may be the post-term non-compete covenant.

It may be pertinent to note that both where the landlord lets the premises [and land] and where the franchisor sublets the premises [and land] to the franchisee the time limitation of 5 years pursuant to Art. 5 para 1(a) of the new Commission Regulation (EU) No 330/2010 does not apply[7].

## 2 The Leasing Process, in general

Landlords **search for concepts** at malls and shopping districts with highest volume (turnover) per sqm.

In order to find lessees, the landlord may or may not use the services of a **broker/finder** the fees of which he pays for but which will be reflected in the amount of rent. On the other hand, frequently, at recruiting franchisees´s the "franchise package" offered contains "search for the business premises, the design, the supervision of build-up" (*Arnold´s Bakery & Coffee Shop*), "shop erection at turn-key terms" (*Bestseller, Jack & Jones, Vero Moda et.al*.) and "the Business premises" (*McDonalds*).

**Lease term**, in general, 3-10 years (with renewal). Most common is 5-6 year lease, with option of renewal for periods of about 3 years each.

**Rents** are expressed in lease on a monthly basis [although noting hinders expressing rents as an annual total] computed per utilized sqm, or as in the case of many shopping malls, a "triple-net rent" divided into

- [i] "the capital lease" computed either per sqm or as a percentage of turn-over (*percentage rent*), with a minimum, *base amount*, and designed to cover the acquisition of the fixed assets (say 25 €/sqm pegged to the cost of living index, plus VAT 23 %,
- [ii] "the maintenance rent" [such as for maintenance of the entire complex incl. parking spaces; insurance, guards, real estate tax, all public utilities, etc., being, say "floating-to-the- market", annually negotiable 6.5 €/sqm + VAT 23 %), and
- [iii] "the marketing fee" for promoting shopping at the mall (say, annually negotiable 1.5 €/sqm + VAT 23 %).

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6 The Supreme Court (the two precedents KKO 1981-II-4 and KKO 1981-II-143) as well as the Helsinki Court of Appeal on 23 Dec. 1999, judgment No 359.

7 Art. 5 para 2

All utilities to be paid as an extra.

If the lease terminates before end of the term, at least in principle, present value of the Capital rent is due, but unless negotiated away, landlord has a certain duty to **mitigate his loss**, however, amounting merely in best endeavours in order to find a new tenant. Nevertheless, malls do not work by merely capital flow, but by flourishing business; accordingly, generally, every effort is made for finding a new tenant.

As security for the fulfilment of all undertakings by the tenant, landlords often require **guarantees** if the tenant is not strong financially and for most franchise leases. Being a bank held security deposit or collateral, the guarantee generally amounts in the equivalent of the rent of 3 months. Shopping malls generally require a deposit pledged with a bank, or where deemed sufficient a guarantee issued by the parent or the franchisor, save for listed companies which generally go free from any suchlike nuisance.

Although, in principle, all financial statements, balance sheets and annual reports are available with the companies registrar (i.e, the trade register held by the National Board of Patents and Registration) for inspection by whomsoever within six months after the end of the financial period, landlords may require financial statement **reporting** and **auditing rights**. This is so, in particular, where there is a percentage rent.

Landlords may require **lien** on fixtures and personal property in space, but can typically be negotiated away.

**Space** conveyed often is a "shell" only, and must be built out to meet franchisor's specifications and specifications acceptable to the landlord.

Sometimes landlord will pay all or part of the **build-out** – which on the tenant's balance sheet is capitalized over lease term and built into rent (because costs must be reimbursed in case of early termination).

Although in many cases held non-appreciable and insignificant in terms of competition law/antitrust law, only rarely landlords or their re-lessor tenants negotiate **"non-compete" clauses** imposing on the tenant the duty to refrain from

- **selling** products or services which compete with tenants, either at the mall, or sometimes, nearby;
- opening **another outlet** nearby, in an effort to support the landlord's percentage rent clause in his lease.

Some tenants are able to negotiate **"exclusives**" which prohibit the landlord from leasing to a competing brand in the mall or in any shopping centre controlled by the same landlord within a certain radius.

Leases generally **limit the use of the space** to the business carried on by tenant when lease is signed ("use clause"). In shopping malls this is in particular so because of the interdependence of the good will.

Leases sometimes require the premises to be operated under a **specified brand name** ("name clause").

Typically there will be restrictions on **exterior signage**, i.e., visual graphics such as wayfinding information created to display information to shoppers/clients inside/outside of buildings.

Leases generally prohibit **assignments**, **re-letting** or **subleasing/subletting** without landlord approval. Upon an assignment, lessors often reserve the right to enter into a new lease with the assignee at market rents. In an effort to refrain from multi-party conflicts Landlords tend to be loath to contractual arrangements with more than one party.