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Key Issues in Franchise Leasing:

Leasing issues that impact franchisors and franchisees

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LEASE NEGOTIATIONS involving a franchised business pose additional challenges beyond the traditional retail lease.

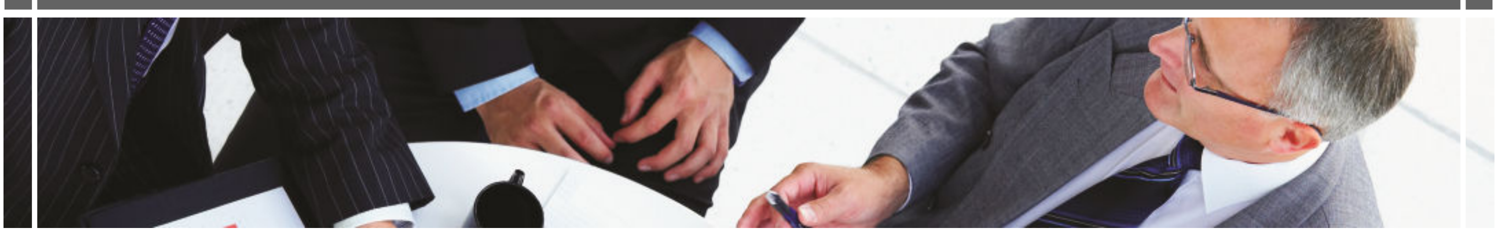
As the business activities of a franchise will be governed by the lease agreement and the franchise agreement, the parties need to have an understanding of how the two documents interrelate to lessen the chance of conflicts.

In addition, a properly negotiated franchise lease should protect the interests of both the franchisor and franchisee.

Some key issues that are unique to franchisors and franchisees are:

- **Permitted Use** –The franchisee should make sure the permitted use under the lease expressly covers the present scope of the franchised operations and any anticipated changes. Both the franchisor and the franchisee may want to negotiate for the right to expand the permitted use to cover unanticipated changes in the franchise operations as well.

- **Transfer Rights** –The franchisor must ensure that it has the right to assign the lease to a new franchisee if the existing franchisee breaches its franchise agreement. Ideally this transfer right should be without landlord's approval, though landlords frequently impose net worth tests (or require a guaranty). Also, the franchisor must make sure that any landlord recapture or termination right (that would apply to a normal request by the tenant to transfer its lease) would not apply to a transfer to a franchisee.



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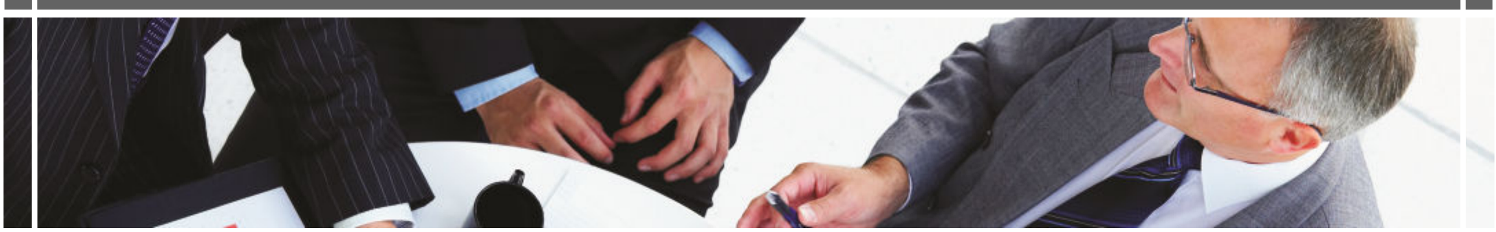
- **Radius Restrictions** – A radius restriction limits a tenant from operating additional stores within a designated distance of the initial site. If the franchisee plan to operate additional sites near the leased location, it is important that the lease not have a radius restriction that would interfere with these plans. Moreover, sometimes these restrictions are drafted so broadly they might arguably prevent a different franchisee from having a store in the radius area. These provisions must be carefully evaluated.
- **Operational Requirements** –Retail leases typically set standards regarding how the tenant must operate its business (e.g., first class merchandise, trained sales staff, seasonally rotated display windows, etc.). The franchisee should ensure that these requirements do not conflict with the provisions of the franchise agreement or the franchisor's business model.
- **Interior & Exterior Design Issues** –A franchisee should ensure that the landlord pre-approves all of the logos, trademarks and signage the franchisee needs to use at the premises.
- **Fixtures & Equipment** –A franchisee that leases or finances its equipment may be required by its equipment lender to obtain certain rights from its landlord to protect the lender's collateral. One common right is the lender's right to access collateral at the premises. The franchisee should ensure that the lease addresses equipment financing if applicable.
- **Lease Defaults** –The franchisor needs to be aware of any deficiency in the franchisee's performance of lease obligations to protect its brand or to prevent loss of a prime location. The franchisor should make sure that the landlord is obligated to give the franchisor written notice of every lease default, and the franchisor should have the right (but not obligation) to cure such default on behalf of the franchisee.
- **De-Identifying the Premises** – Franchisor should ensure that if the lease is terminated, the landlord provide the franchisor with access to the premises and adequate time remove from the premises signage, menus, logos and any other trademarked property. This is known as "de-identifying" the premises.



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