

**Thursday, November 4, 2021
8:00 AM – 9:15 AM**

Peer to Peer 3

**Franchisor Lease Addendums:
Thought You Were Done Negotiating The Lease? Think Again.**

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OVERVIEW

The good news: Your client, the owner of a brand new shopping center in a desirable location, is preparing to sign a lease with a new tenant that will provide goods or services catering to the type of clientele that will bring lots of traffic to its property and exponentially increase the value of its investment.

The bad news: Your client's new tenant is the franchisee of a major national brand, and while your client would love having that brand's logo on a storefront if its new center, your client has to make sure that the new tenant's franchisor approves your client's deal with the tenant.

The relationship between a landlord and a tenant can become complex if the tenant is a franchisee. While a landlord generally expects to have one-on-one relationships with each and every tenant in its shopping center, the reality is that franchisee tenants bring another party into the relationship: that tenant's franchisor. The franchisee's operations are largely comprised of the intellectual property owned by its franchisor, such as a highly recognizable brand, well-known products or services, and tried and tested profitable business processes. The franchisee, therefore, must operate in a way that the franchisor approves, otherwise it may lose the rights to operate its business under that brand.

Every landlord wants to increase the value of its shopping center. Having nationally-recognized brands with a strong following that attracts traffic is essential, as those types of tenants raise the profile of a center, making it desirable to other tenants and, therefore, potentially increasing the rents that the landlord can seek from those tenants.

The franchisor, meanwhile, wants to spread its brand among operators in whom it has confidence will represent the brand well. The franchisor's primary asset is the intellectual property used by its franchisees. Its primary concern is to make sure that its brand is well maintained. It must make sure that no operation using its brand devolves into a sub-standard, inferior business. Such an operation would damage the franchisor's most valued asset. Therefore, the franchisor wants to be notified if its franchisee is not meeting its obligations to a landlord, and also seeks the right to replace the operator of a poorly run franchise with a better operator. Ultimately, it wants the right to take over an unacceptable operation itself in order to "right the ship."

The relationship among these three parties can provide for an interesting lease negotiation. Understanding the needs of each can be crucial to getting a deal done.

DESCRIPTION OF SESSION

You've finalized negotiating the lease for a new franchisee location in your center, but then you are presented with the "Franchisor Addendum". What is it and why is it necessary? This peer-to-peer will examine a franchisor addendum and how it interacts with the rest of the lease.

FACT PATTERN 1

Your client Ownerco is the owner of a suburban office building with retail stores on the first floor. You have prepared and are negotiating a lease for an ice cream shop on the first floor with Tenantco. You are near the end of negotiations of the lease with Tenantco and you receive a lease rider that Tenantco informs you is required by its franchisor Franchisco. Turns out the ice cream shop is a franchise operation and Tenantco is a franchisee of Franchisco. Who knew. Ownerco has contacted you with questions about certain provisions in the Franchisco rider and how they interact with the negotiated lease.

QUESTIONS FOR FACT PATTERN 1:

1. Review the attached provisions from the Franchisco rider regarding assignment of the lease to Franchisco. What sections in the lease might these rider provisions interact or conflict with? What concerns should your client Ownerco have about assigning the lease to Franchisco or a new franchisee? As Ownerco's counsel, what changes would you recommend to these provisions?
2. Review the attached provision from the Franchisco rider granting Franchisco rights to access the premises. How might these access rights interfere with your Ownerco's operation of the property? What other concerns might Ownerco have regarding the Franchisco access? Are there any limitations or conditions on Franchisco's access to the premises that you would recommend to your client Ownerco?
3. Review the attached provisions from the Franchisco rider regarding notice to Franchisco and an opportunity to cure. What lease provisions might this notice and cure requirement interact or conflict with? What other concerns might Ownerco have regarding this Franchisco right? Would you recommend to Ownerco any revisions to these rider provisions?
4. The Franchisco rider includes a subordination of Ownerco's lien rights to lien rights of Franchisco. See the attached provision. How would you advise your client regarding the effect of this subordination? Are there any protections you would advise for you client Ownerco?

ASSIGNMENT TO FRANCHISOR

Franchisee assigns to Franchisor all of Franchisee's rights, title and interests to and under the Lease upon any termination or expiration without renewal of the Franchise Agreement, but no such assignment shall be effective unless and until: (a) the Franchise Agreement is terminated or expires without renewal; and (b) Franchisor exercises its option under the Franchise Agreement and this Rider to assume Franchisee's interest under the Lease by notifying Franchisee and Landlord in writing that Franchisor assumes Franchisee's obligations under the Lease.

If Franchisor assumes the Lease, as provided above, Franchisor may, without Landlord's prior consent, further assign the Lease to another franchisee of Franchisor to operate a Franchise shop at the Premises provided that the proposed franchisee has met all of Franchisor's applicable criteria and requirements and has executed a franchise agreement with Franchisor. Upon such assignment and assumption to and by such franchisee of Franchisor, Franchisor shall be released from any liability under the terms and conditions of the Lease accruing after the effective date of such assignment and assumption.

ACCESS RIGHTS

Franchisee has agreed under the Franchise Agreement that Franchisor and its employees or agents have the right to enter the Premises for certain purposes. Subject to the terms and conditions of this Lease, Landlord agrees not to interfere with or prevent such entry by Franchisor, its employees or agents. If the Franchise Agreement expires (without renewal) or is terminated, then Franchisee has an obligation under the Franchise Agreement to take certain steps to properly de-identify the Premises as a Franchise shop (unless Franchisor takes an assignment of the Lease, as provided above). Subject to the terms and conditions of the Lease, Landlord agrees to cooperate with

Franchisor in enforcing such obligations under the Franchise Agreement against Franchisee, including permitting Franchisor, its employees or agent, to enter the Premises and remove any signs (both interior and exterior), décor and/or any other materials displaying any marks, designs, slogans and/or logos associated with Franchisor. Franchisee acknowledges that, under the Franchise Agreement, if Franchisee fails to de-identify the Premises, Franchisee has agreed to pay to Franchisor upon demand Franchisor's then-current fee and expenses incurred for de-identifying the Premises.

FRANCHISOR NOTICE AND CURE

Landlord agrees to furnish to Franchisor copies of any and all letters and notices sent to Tenant pertaining to the Lease and the Premises at the same time that such letters and notices are sent to Tenant. Without limiting the foregoing, in the event of any default by Tenant, Landlord shall give Franchisor written notice of such default. If Tenant has failed to cure such default at the expiration of the applicable cure period, Landlord shall give Franchisor further written notice of such failure ("Franchisor Notice"). Following Franchisor's receipt of the Franchisor Notice, Franchisor shall have the right (but not the obligation) to cure Tenant's default before Landlord shall exercise any of Landlord's remedies arising as a consequence of Tenant's default. Any such cure shall be effected within 30 days following Franchisor's receipt of the Franchisor Notice. Such cure by Franchisor shall not be deemed to be an election to assume the terms, covenants, obligations, and conditions of the Lease.

Franchisor notice and cure (continued)

If Franchisor cures Tenant's default, or if Franchisor notifies Landlord that the Franchise Agreement has been terminated (which termination shall constitute a non-curable default pursuant to the Lease upon Landlord's receipt of Franchisor's notice thereof), Landlord agrees, upon Franchisor's written request, to assign to Franchisor any and all rights that Landlord may have under the Lease to remove and evict Tenant from the Premises and shall cooperate with Franchisor in order to pursue such action to a conclusion.

If Franchisor cures Tenant's default, or notifies Landlord of the termination of the Franchise Agreement, Franchisor shall have the right and option, upon written notice to Landlord, to do the following:

Undertake to perform the terms, covenants, obligations, and conditions of the Lease on behalf of the Tenant (notwithstanding any removal or eviction of Tenant) for a period not to exceed six (6) months from the first date of any cure by Franchisor; or

At any time within or at the conclusion of such six-month period, assume the terms, covenants, obligations, and conditions of the Lease for the remainder of the term, together with any applicable renewal options. In such event, Landlord and Franchisor shall enter into an agreement to document such assumption. Franchisor is not a party to the Lease and shall have no liability under the Lease unless and until said Lease is assigned to, and assumed by, Franchisor as herein provided.

LIEN SUBORDINATION

Landlord shall subordinate any lien in favor of Landlord created by the Lease to Franchisor. Landlord's rights to collect on any liens that Landlord files or attaches to Tenant's property rights shall be subordinate and inferior to Franchisor's lien rights against any and all of the personal property, furnishings, equipment, signs, fixtures, and inventory owned by Tenant and on the premises operated by Tenant under the Lease.

FACT PATTERN 2

Same facts as Fact Pattern 1, except now your client is Tenantco. Ownerco's counsel has received Franchisco's rider and provided responses to the various provisions as you recommended in your discussion of Fact Pattern 1.

QUESTIONS FOR FACT PATTERN 2:

1. In Fact Pattern 1, your client Tenantco presented the Franchisco rider towards the end of the Lease negotiations. Would you have advised that? Is there some other time in the Lease process you would advise that your client present the Franchisco rider to Ownerco?
2. Discuss your recommended Ownerco responses from Fact Pattern 1 and recommend responses from your client Tenantco.
3. In addition to responses to Ownerco, consider responses to Franchisco and other protections you might offer to Franchisco if Ownerco has not accepted all or portions of the Franchisco rider.