LEASE ISSUES PECULIAR TO FRANCHISE SYSTEMS

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Lease Issues Peculiar to Franchise Systems

I. Introduction

The key ingredients in almost every successful franchise system are brand recognition, consistency and continuous operations. These attributes create valuable goodwill for the company’s trade name, and in turn make it easier to sell franchises. The starting point for achieving that success is finding, securing and retaining great retail sites. The site could be operated as a restaurant (such as a McDonald’s® restaurant), a store (such as a Wild Bird® Center), a hotel (such as a Cambria Suites® hotel), an office (such as a We The People® document preparation service) or another type of operation (such as a The Little Gym® gymnasium). As the old adage goes, the three principles of real estate success are “location, location, location.”

Because site selection and continuous operations are so valued by successful franchisors, they expend considerable resources protecting their valuable properties. For both franchisor and franchisee, the leased premises must meet the franchisor’s established criteria for a successful franchised business. In addition, it is important that the lease contain certain provisions to protect the parties’ respective positions. This paper discusses those criteria and those lease provisions that are unique to a franchise system, from the franchisor’s, franchisee’s and landlord’s points of view. We will also discuss the pros and cons of placing such provisions in the franchisee’s lease with the landlord versus the franchisor entering into a lease agreement with the landlord and subletting the premises to the franchisee.

II. Considerations Specific to Leases of Premises for Franchised Businesses

A. The Franchisor’s Interests

The franchisor is interested in seeing its franchisees prosper. However, it also has an interest in retaining control of valued real estate upon the expiration or termination of a franchise agreement. Assuming that the franchised business was doing well or could be turned around with a different operator, the franchisor would want to continue the operations of the franchised business at the premises, either directly or indirectly through another franchisee. Moreover, it needs to ensure that the franchisee or a third party does not operate a similar concept bearing a different name, thereby capitalizing on the franchisor’s locational goodwill.

Although a restrictive covenant might serve to prevent that occurrence with respect to the franchisee, it would not serve that purpose with a third party or under circumstances in which post-termination restrictive covenants are unenforceable, such as in California.

In addition to retaining control of the real estate, the franchisor wants the terms of the lease to be favorable to the franchisee so that the franchisee’s operation of the franchised business has the best chance to be successful and, in the event that the franchisor or another of
its franchisees assumes the lease upon the expiration or termination of the franchise agreement, that operator’s business will have those same favorable terms.

In most franchise systems, the franchisee will directly contract with an unrelated landlord for space. In those cases, the preferred method of the franchisor imposing indirect control over the premises is inserting certain provisions into the lease between landlord and franchisee, together with a collateral assignment of lease between franchisor and franchisee, which is agreed to by the landlord in a writing. Typically, the method for inserting the mandated lease provisions is a rider to the lease (herein, the “Lease Rider”). The Lease Rider will expressly designate the franchisor as an intended third-party beneficiary. Set forth below are the specific interests franchisors seek to protect through a Lease Rider.

1. **Maintaining Uniformity in the Franchise System**

   a) **Use of marks**

   The franchisor needs to ensure that the lease permits the franchisee to (i) use the franchisor’s trademarks in signage and otherwise in connection with the leased premises and (ii) build-out the leased premises in a manner consistent with the functional needs of the franchised business and the franchisor’s mandated trade dress. To satisfy these requirements, the franchisee should submit to the landlord, in advance of lease execution, a design plan for the leased premises, including the trademarks and the signage features. In turn, the landlord should provide its express written approval to use the trademarks, desired signage, functional build-out and trade dress. The franchisor should require the franchisee to submit to it a copy of the landlord’s consent to the design. Some landlords (such as Desert Ridge Marketplace, immediately south of the JW Marriott Desert Ridge Resort & Spa), desire a uniform appearance or theme and, therefore, require that each retailer’s signage be designed by the landlord’s architect; modifications to the franchisor’s trademark may be required. Further, the parties should confirm that applicable zoning actually permits the franchisor’s signs and trademarks to be displayed. See Appendix 1 for sample provisions to consider for insertion into the Lease Rider.

   b) **Operation of the premises**

   The use clause of the lease should expressly permit the franchisee to operate the franchised business (including the sale of the full range of product and service offerings) at the leased premises. The lease should also expressly permit the franchisee to remodel the leased premises and change the signage as the franchise system’s format and trademarks evolve over time. Most retail leases will call for the landlord’s consent for alterations over a base threshold dollar amount. Landlords justifiably want to review and approve work which impacts their property, especially the structure. However, franchisors need to know that the re-imaging

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3 Municipalities have caused franchise systems to alter marks in signage. In Payless Shoesource, Inc. v. Town of Penfield, 934 F. Supp. 540 (W.D.N.Y. 1996), the court enforced a municipal sign ordinance that required all signs to be one color. Payless’ federally registered mark contained both yellow and orange. The Payless court naively reasoned that the town was simply imposing a uniform sign ordinance and that the sign and trademark were two difference concepts. In contrast, the court in Blockbuster Video, Inc. v. City of Tempe, 141 F.3d 295 (9th Cir. 1998), found the Lanham Act prohibited the municipality from requiring the mark owner to alter its registered service marks, but that the municipality could preclude display of the marks. For an excellent discussion of the conflict between sign ordinances and Section 1121(b) of the Lanham Act, see Roberta Rosenthal Kwall, Regulating Trademarks or Exterior Signs: Should Local Law Trump the Lanham Act and the Constitution?, 71 S.CAL. L. REV. 1105 (Sept. 1998).
programs may be completed. Accordingly, franchisors like to see a carve-out from the landlord approval requirement for system-wide mandated remodel projects.

If the landlord previously granted anchor tenants (or other tenants with significant leverage) exclusivity clauses, the landlord arguably cannot grant the franchisee the right to engage in a prohibited business or sell a prohibited product or service. If that is the case, the franchisee may need to obtain waivers or consents from such tenants to permit the proposed use. Compromises often include *de minimus* exceptions, such as: “tenant agrees not to display for sale more than 10 linear feet of a particular product or products.”

At the same time, the franchisor needs to limit the franchised unit’s operations to those contemplated by the franchise agreement. The franchise agreement will virtually always prohibit the franchisee from operating as anything other than a system unit. The lease’s use clause will further protect the franchisor by causing the landlord to monitor the tenant’s use of the premises. In addition, and more importantly, upon a tenant’s/franchisee’s bankruptcy, the use clause would limit the assignment of the lease to the franchisor or an approved franchisee because that could be the only party permitted to operate under the lease’s use clause.

2. **Preserving Control Over the Lease Premises**

   a) **Lease assignment**

   In addition to requiring the lease to contain certain other control provisions, franchisors often require the Lease Rider to contain a collateral assignment or the signing of a separate collateral assignment agreement. In a collateral assignment, the franchisee presently assigns to the franchisor the franchisee’s rights under the lease, but the exercise of the assignment rights is contingent upon a condition subsequent, typically, the franchisee’s default under the lease or the franchise agreement and the franchisor has the right to elect whether or not to exercise those rights. If the franchisor exercises its rights, it usually must cure the franchisee’s defaults under the lease and otherwise assume the franchisee’s obligations under the lease. Depending upon the parties’ respective leverage at the time that the franchisor is considering whether to exercise its rights to take over the lease, the franchisor may be able to negotiate a reduced cure amount with the landlord. The collateral assignment should also clearly state that the franchisor’s cure of the franchisee’s defaults under the lease will not excuse the franchisee from liability for the amount expended by the franchisor to do so. A careful franchisor will seek to preserve recovery rights against the franchisee/tenant for these payments. The collateral assignment must be consented to by the landlord at the time the lease is signed (not at the time that the franchisor desires to exercise its rights); otherwise, the landlord may not be obligated to recognize the franchisor’s rights to the premises under the lease and the landlord may try to extract more favorable terms from the franchisor upon the tenant’s/franchisee’s default.

   Optimally, the collateral assignment would allow the franchisor (or its designee) to take over the franchisee’s position under the lease, without having to satisfy (or having its designee satisfy) any additional requirements. The landlord, in contrast, desires to ensure that the party occupying the premises has the ability to make the required payments and successfully operate the franchised business. Therefore, landlord should retain the right to approve or disapprove the party taking over the franchisee’s position under the lease. Whether the landlord’s consent to the franchisor (or its designee) taking over the franchisee’s rights is required will depend upon the respective leverage of the parties. As a compromise, the parties may agree that the landlord’s consent will not be required if the franchisor or the other franchisee meets certain agreed-upon financial and operational criteria.
The franchisor should seek to minimize its exposure under the lease if it assumes the franchisee’s position under the lease. First, it may seek to do so under the circumstances in which it operates the franchised business at the leased premises only on a temporary basis, as necessary until another approved operator assumes the franchisee’s position. Second, it may seek to do so under the circumstances in which it operates the franchised business at the leased premises, but subsequently decides to cease operating and close operations. Depending upon the respective leverage of the franchisor and the landlord, the landlord may agree that the franchisor will not be liable beyond the date of the assignment of the lease to the successor franchisee or may agree to limit the franchisor’s exposure to a stated dollar amount or a number of months of rent. By way of example, a franchisor with leverage may be able to negotiate that the cure amount will be limited to the 30-day period prior to landlord’s default notice and forward. This way the landlord is motivated to send default notices promptly (and to the franchisor too, an additional step landlords often dislike to take), which keep the franchisor apprised of the franchisee’s financial condition.

Some franchisors will request the right to exercise renewal or extension options that the franchisee/tenant fails to exercise. This is another way of protecting locational goodwill. If granted, the franchisor, following notice of the failure to exercise, would have the right to assume the lease for the option period, and upon satisfaction of the franchisee’s lease obligations, the franchisee would be released.

b) **Amendments to the lease only with the franchisor’s consent**

The franchisor needs to know that the lease cannot be amended (in any respect, in any material respect or, at a minimum, in any respect that may adversely affect franchisor’s rights) without the franchisor’s consent. Further, the tenant/franchisee should not be allowed to renew the lease or extend the term without the franchisor’s consent. Being able to do so could defeat the purposes in the Lease Rider and the franchisor would not even know that the protections have been eliminated. For many franchisors it is important that the term of the lease match the term of the Franchise Agreement to ensure that the franchisee (1) has a physical location from which to operate during the franchise agreement term and (2) does not retain the premises (and with it the attendant goodwill) without operating under the franchise system (i.e., not in competition with the franchised business).

The franchisor wants to restrict the franchisee’s ability to assign its rights under the lease (specifically, to an existing competitor, to one who will operate the premises as a competitor and, generally, to any person), without the franchisor’s consent. For similar reasons, subleasing without the franchisor’s consent should be prohibited.

Although a landlord may impose a radius restriction (i.e., a covenant that the tenant will not operate a similar business within a certain mile radius of the leased premises, designed to focus the tenant on succeeding at the landlord’s center) on the tenant/franchisee with respect to other operations of the franchised business, the franchisor needs to ensure that those restrictions do not extend to the franchisor (by virtue of being a party to a Lease Rider or by exercising its rights to assume the lease) and prohibit the franchisor from operating, or licensing others to operate, the franchised business (or any other business) in proximity to the leased premises.

Finally, the franchisor should require that the landlord provide the franchisor with a copy of any notice of default at the same time that such notice is given to the franchisee, as well as the opportunity (but not the obligation) to cure the default (optimally with an additional period to
cure, beyond the tenant’s cure period). The lease should provide that a default under the lease will be a default under the franchise agreement. In the event that the franchisor does not use a cross-default provision, simply adding the loss of the right to occupy the underlying premises as a ground for termination of the franchise agreement should suffice.

3. **Bolstering Its Enforcement Rights under the Franchise Agreement**

   a) **Right to receive reports**

      The franchisor should have the right to obtain the franchisee’s revenue or sales information submitted to the landlord (e.g., in connection with a percentage rent arrangement) for the purpose of verifying the franchisee’s reporting information and royalty and other payments to the franchisor. Placing this requirement in the lease, in addition to the franchise agreement, permits the franchisor to receive the reports directly from the landlord, instead of simply relying upon the franchisee to furnish them.

   b) **Inspection rights**

      The franchisor should have unrestricted access to the leased premises, without liability for trespass, to ascertain compliance with the franchise agreement and the lease. Especially important is the franchisor’s ability to cause a de-identification of the premises, including the right to remove signage and fixtures. At the end of the franchise agreement’s term, whether due to expiration of termination, the franchisor must be able to enforce the franchise agreement’s post-termination obligations.

   c) **Enforcing the Lease Rider**

      Once the effort is made to create a Lease Rider, the franchisor needs to know its intent will be enforced in its favor. A clause should be included in the Lease Rider explicitly stating that the Lease Rider supersedes and controls over any conflicting or inconsistent provision of the lease. Additionally, the franchisor must be able to show standing to enforce its rights. Franchisors create standing by being either (1) a party to and executing the Lease Rider or (2) designated an intended third party beneficiary, with the right to enforce the lease and/or Lease Rider in its own name. To further support the third party beneficiary designation, a franchisor will also often enter into a separate collateral lease assignment agreement with the franchisee/tenant. The collateral assignment would then be consented to, in writing, by the landlord. Again, if the franchisor is not a party to the Lease Rider, it must state that the franchisor is an intended third-party beneficiary, with the right to enforce its terms. A franchisor who does not sign the Lease Rider as a party may be trying to limit its exposure for potential liability under the lease.

      After the franchisor exercises its right to take over the leased premises, the tenant may argue that it is relieved from obligations to the landlord. To prevent such a position from being successful, a provision may be added to the Lease Rider stating that the tenant shall remain liable to the franchisor for reimbursement for all amounts paid by franchisor to landlord to cure the tenant’s defaults.

      Courts will generally enforce lease assignment provisions in favor of franchisors, especially where the franchisor’s enforcement rights are acknowledged by the landlord. The
leading case on enforcing lease assignment provisions is *Snelling & Snelling v. Martin*.\(^4\) The *Martin* court upheld a franchise agreement provision that required the franchisee to assign its lease to the franchisor upon termination of the franchise agreement. The court recognized the importance of protecting the franchisor’s “locational goodwill” and granted preliminary relief. The court stated, “the lease assignment provision in this case is apparently intended to allow Snelling to retain clients who are familiar with the precise location of the business; if defendants remain in the premises and Snelling is forced to operate elsewhere, it loses the intangible benefit of that location. The *Martin* court also directed the defendants to cooperate as necessary for Snelling to obtain the telephone numbers associated with the franchised business. Lease assignment provisions are particularly useful to franchisors in California, where covenants not to compete are unenforceable. Without the lease assignment provision, breakaway franchisees would have greater success in blocking a franchisor from protecting its interest in the more attractive franchise locations.

Other courts have also enforced lease assignment provisions. In *Dunkin’ Donuts, Inc. v. Dowco*,\(^5\) the court determined that a lease option agreement between a franchisee and its landlord, which prohibited the landlord from leasing the location to a competitor and granted the franchisor the right to assume the lease, was enforceable. The court ordered specific performance in spite of the fact that it was a unilateral option contract not signed by the franchisor.\(^6\) Similarly, in *Dunkin’ Donuts of America v. Middletown Donut Corp.*,\(^7\) the New Jersey Supreme Court affirmed the enforcement of a lease assignment provision and compelled a terminated franchisee to turn over the leased premises to the franchisor. In contrast, the court in *Trient Partners I, Ltd. v. Blockbuster Entertainment Corporation*\(^8\) permitted a franchisee to freely sell its leases, together with its video store assets, to a third party upon the expiration of the franchise agreement, despite the fact that certain of the leases provided the franchisor the right to assume the leases upon default. The court first noted that the franchisor’s right to assume would only be triggered upon a default by Trient, not upon the expiration of the franchise agreement. The court, applying Texas law, found real estate to be “unique.” Even if the agreement gave Blockbuster the right to assume the leases in the absence of a default by Trient, Blockbuster would not have equitable title because there was no privity of contract between Blockbuster and Trient’s landlord.\(^9\) This case underscores the practical advice that if the franchisor is not a party to the lease, the franchise agreement must provide that the lease identify the franchisor as a third party beneficiary under the lease, with the right to enforce its rights to assume the lease. This strategy will create privity between the landlord and the franchisor and clearly allow the franchisor to enforce the lease terms against the landlord in the future.

In *Cottman Transmission Systems, Inc. v. Hocap Corp.*,\(^10\) the franchisor sought to enforce the collateral assignment provision in its Lease Rider against the landlord. After the franchisee defaulted, the landlord did not provide franchisor the mandated 20-day written notice before the landlord repossessed the leased premises. The appellate court overruled the trial court’s finding that the franchisor had no standing to enforce the Lease Rider. The landlord


\(^6\) It helped Dunkin’s case that the franchisee and the landlord were related parties.

\(^7\) *Dunkin’ Donuts of Am. v. Middletown Donut Corp.*, 495 A.2d 66 (N.J. 1985).


\(^9\) *Id. at 753. The Court stated that “Blockbuster is not bound by Trient’s leases, as probably would be required for it to bind Trient’s landlords.” The language, which is dicta in the case, appears to undermine the validity of third party beneficiary clauses.

argued that the assignment was conditional and that the franchisor had not perfected its rights under the assignment. The appellate court agreed with the franchisor’s position that it had the 20-day period within which to exercise its option to make the conditional assignment effective. When the landlord repossessed the leased premises and altered the space in a manner making it unfit for the operation of a transmission repair center, the landlord had committed an anticipatory breach of the contract.

The importance of having a landlord acknowledge and consent to the collateral assignment is highlighted by *Danbury Mall Associates Ltd. Partnership v. Mazel Enterprises, LLC*¹¹ Mazel was a franchisee of Candy Express Franchising, Inc. The franchisee opened a store in a mall in September 2001 and abandoned the space in November 2002. The franchisor guaranteed the lease on a one-year rolling basis. Following the abandonment by the franchisee, the franchisor tried to take over the space by virtue of a collateral assignment executed by the franchisee. However, the franchisor offered no evidence that the landlord had consented or acquiesced to the assignment. Despite the franchisor’s willingness to cure and continue operations, the landlord rejected the assignment. Had the landlord consented to or acquiesced to the collateral assignment, the franchisor would likely have been able to enforce it.

**B. The Franchisee’s Interests**

1. **Quick Execution of Acceptable Form**

   The franchisee’s goal is to expeditiously find a suitable location and execute a lease in a form acceptable to the franchisor, in a manner as to meet the franchise agreement time deadlines for signing a lease and opening the franchised business. Therefore, one of the basics for a franchisee in lease negotiations is to expressly make the lease contingent on the franchisor’s approval of the form and substance. With the right to terminate, the franchisee will have an easier time insisting on the terms required in the franchisor’s Lease Rider. Once the lease is ready for franchisor-reviewed approval, the franchisee hopes for a franchisor that appreciates the time pressures of lease negotiations and will produce a fast turnaround time.

2. **Franchisor-Related Benefits**

   The franchisor’s reputation, success and contacts may assist the franchisee in locating, and gaining access to, a prime location, one it might otherwise not have had the opportunity to lease. In addition, although franchisors typically will not guarantee a franchisee’s obligations under its lease, a franchisor that is willing to do so can assist its franchisees in gaining access to locations that the franchisee’s credit alone may not provide. Furthermore, with the franchisor standing behind its franchisee’s obligations, the franchisee will increase its leverage in negotiating the lease terms. The landlord should be impressed that the franchisor is betting on the success of the franchisee and the site by putting its own assets at risk. (See also Section D below entitled “Lease by the Franchisor from the Landlord and Sublease to the Franchisee.”)

3. **Financing the Franchised Unit**

   a) **Collateral**

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To complicate matters, franchisees often obtain loans. The franchisee’s lender needs to be satisfied that it has underwritten an acceptable loan. The lender may seek an assignment of the lease (a leasehold mortgage interest) in addition to a pledge of the franchise agreement. This presents an obvious and direct conflict with the franchisor’s objective of being able to retain the locational goodwill (and to specifically approve any successor franchisee). The franchisee becomes caught in the middle of this tug-of-war. Most often, the franchisor will win, and a leasehold mortgage will not be permitted, as it would interfere with the franchisor’s rights under the collateral assignment. The lender will often settle by accepting a security interest in the franchisee’s furniture, fixtures and equipment. To obtain a priority lien on these items, a landlord may have to waive its statutory lien on these assets. In many states, a landlord is entitled to a statutory lien on tenant’s personal property to the extent of unpaid rent. To satisfy its lender, the franchisee will need the lease to provide that the landlord waives, or at least subordinates, its landlord lien to the lender.

b) **Estoppel Certificates**

When a lender finances a franchised unit, it will want to know the status of the lease from time to time. An estoppel certificate, a written statement from the landlord, will confirm certain information about the status of the lease. The purpose is for the lender to rely on the information in assessing its position and to estop the landlord from later arguing facts to the contrary of the certificate. Accordingly, the franchisee, who receives or intends to receive, financing should include an obligation on the part of the landlord to supply an estoppel certificate upon request. A franchisee lender seeks some of the same protection a franchisor desires in the Lease Rider. In the absence of a franchisor seeking control of the site upon a default or termination (under either the lease or the franchise agreement), the lender’s form of estoppel may include some of the following:

- The lease term, including commencement and expiration dates and renewal option, and the amount of rent and security deposits.
- The date through which rent has been paid.
- A statement that the lease is in full force and effect and that there are no existing defaults under the lease.
- Landlord consents to lender’s security interest in the lease.
- No lease amendment without lender’s consent.
- Lender has no obligations under the lease, unless and until it has exercised its right to foreclose on its security interest.
- Landlord agrees to provide notice to lender at the same time it sends notices to the franchisee.
- If lender becomes the tenant, it may elect not to operate or may alter the use of the premises.  

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13 This is another reason why the franchisor wants the lease to have a narrow use provision, which may not be altered without franchisor’s consent.
4. **Exclusivity Rights**

Some franchisees will be able to negotiate an exclusivity clause: a landlord’s covenant to refrain from leasing to a competitor. Exclusivity clauses are generally enforceable if reasonable in territory, time and person. A exclusivity clause generally appear in two categories: (1) an exclusive right to conduct a specified business, which is not literally directed against specific products, and (2) an exclusive right to sell specified products. A right to conduct the only pizza shop in the shopping center may permit other food tenants to sell products also sold in the pizza shop, whereas, the exclusive right to sell pizza and pizza-related products would be a true exclusive. Since franchisees are subject to a franchise agreement - which will typically provide that the franchisor has the right to modify the products and services being offered by the franchisee - it may want a limited exclusive. That is an exclusivity clause where the landlord covenants not to lease to a tenant having the same principal business. But if the core items being offered by the franchisee will not change, a true exclusive would be more appropriate. The lease would list the restricted items and other tenants would not be permitted to offer them for sale. An aggressive franchisee may propose that it receive an exclusive right to sell the “items then being sold by the franchise system.” The problem with evolving or expanding use provisions is that they limit the landlord’s future leasing possibilities and increase the possibility of a future violation. Accordingly, landlords are generally more willing to limit any restrictions to the primary items being offered as of the date of the lease. Where the landlord is flexible and permits a future expanded exclusive, expect the landlord to insist on advance notice of the new items and no exclusivity rights for items already covered in another tenant’s exclusivity clause.

5. **Control Following Termination**

The franchisee should seek to eliminate continuing liability under the lease if the franchise agreement expires or is terminated, if the franchised business is transferred or if the franchisor takes possession of the leased premises pursuant to the collateral assignment. Although this would be doubtful from a contractual point of view, it is likely from a practical point of view if the franchisor operates the franchised business in succession to the franchisee or if the franchised business is transferred to a strong franchisee.

If, however, after the franchise agreement expires or is terminated the premises will not continue to be operated as a franchised business and the franchisee has continuing liability under the lease, the franchise needs to have the latitude to assign or sublease it to whomever may be interested in taking over the leased premises (without limitations on the nature of the business that may be conducted).

C. **Landlord’s Interests**

1. **Quality Tenants and Good Mix**

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15 M. FRIEDMAN, FRIEDMAN ON LEASES § 28:7 at 36 (5th ed. PLI 2007).
The landlord needs to have quality brand name tenants with an appropriate mix of types across the shopping center. It wants continuity, despite franchisor-franchisee tensions, for optimal sales/rent levels; to retain and attract other tenants; and to maintain a valuable relationship and thus leverage with its lender. Therefore, it may be attracted to a member of a franchise system as a tenant and be amenable to making concessions that benefit the franchisor.

2. **Certainty of Payments**

The landlord needs to have certainty of rent and common area maintenance (CAM) payments. It needs to know that it will have sufficient cash flow to meet its debt and other monetary obligations and, hopefully, realize a return on its investment. It needs continuous operation, which benefits the other tenants and the public at-large. Therefore, it may be willing to agree to certain provisions that facilitate the franchisor (or a subsequent franchisee) succeeding to the franchisee’s interest upon the expiration or termination of the franchise. Those provisions, however, would optimally provide the landlord with assurances regarding the successor operator’s ability to make the required payments and successfully operate the franchised business. Before a landlord should permit the franchisor to step into its tenant’s shoes and operate the store itself or re-franchise it, there should be an appropriate level of security. For example, in order for the franchisor to take an assignment of the Lease, it must cure all outstanding defaults, without exception or limitation, and it must remain liable for the remainder of the term regardless of future assignments. Any franchisee/assignee must meet financial capability standards and the franchisor may not assign the lease to a shell affiliate. In contrast, franchisors seek to limit the cure amounts to 30 days (or an amount tied to default notices delivered to franchisor) and seek a full release upon assignment to a new operator.

3. **Consistent Look and Operations**

The landlord often wants its shopping center to have a uniform appearance or theme and, therefore, may require that each retailer’s signage be consistent with that appearance or theme. In those instances, the landlord will involve their architect in creating or approving the tenant’s façade.

Further, certain landlords expect that the businesses operated at their development will have consistent hours of operation. Therefore, exceptions to the franchisor’s “standard” hours of operation may be necessary.

4. **Protection of Premises**

In response to a franchisor’s need to enter the leased premises, without liability, to “protect the system” (for example, to remove signage bearing its trademarks and/or obtain possession of its operating manual), the landlord should require a high threshold for such action. There should be evidence of a material default, which has not been remedied after notice and an opportunity cure. Further, if the franchisor does enter the leased premises for the purpose of protecting the system, it should first provide evidence of insurance to the landlord and agree to indemnify the landlord for any costs or losses incurred by landlord resulting from such entry.

5. **Right to Approve Future Operators**
The flip side of the franchisor’s desire to be able to assign the lease to itself or a subsequent franchisee is the landlord’s desire to control who its tenant will be. Landlords with leverage will require the franchisor to remain liable for the franchisee’s/tenant’s obligations in the event of an assignment to a successor franchisee and will perform due diligence with respect to such franchisee, the same way it would a new prospective tenant. If the new operator lacks sufficient financial resources and operational experience, the landlord will want the right to reject the assignment request. In any event, the right to assign to either the franchisor or the next franchisee should be subject to the landlord’s consent, in its sole judgment.

6. Non-Competition in Close Proximity

The landlord wants to prevent tenants from operating competing units within a particular radius of the premises that may draw sales (and, therefore, rents payable to the landlord) away from the premises. Although franchisees may not be concerned about these radius-restriction provisions, most franchisors would not be amenable to agreeing to this provision. Franchisors, especially those who do not grant territorial protection, want to retain the right to exploit their brand as deemed necessary, without restriction from a landlord. In fact, diligent franchisors will request in the Lease Rider that the landlord waive the radius restriction applicable to the franchisor upon assignment of the Lease to the franchisor.

7. No (or Narrow) Exclusive Rights

For administrative reasons and to maintain maximum future leasing flexibility, landlords try to avoid exclusivity provisions. If necessary to lease-up the center, the landlord will limit exclusive rights to a steady, express list of protected items not to be sold by other tenants. It will strongly resist a broad evolving concept such as “all items then being sold by the majority of franchisees operating under the ABC Franchise System.” Such a clause would be impractical to enforce. Other existing tenants would not have a clear understanding of the restriction, and the landlord would be severely challenged in its ability to lease to new tenants.

8. No Additional Notice to Parties

Landlords often resist the administrative burden of sending copies of tenant notices to the franchisor and the franchisee’s lender or partners. It seeks simplicity, as the person who is sending out the notice may not have, or may not review, the various ancillary documents (e.g., collateral assignment of lease) that require additional notice to parties.

D. Lease by the Franchisor from the Landlord and Sublease to the Franchisee

To bolster the franchisor’s control of the premises, including the ability to remove an uncooperative terminated franchisee from the premises on an expeditious basis, a franchisor may elect to lease (or have a dedicated affiliated company lease) the premises from the landlord, and then sublease the premises to a franchisee. The franchisor may choose this mechanism, regardless of whether it or the franchisee selected the site.

The franchisee needs to be able to continue operating the franchised business in the event of the franchisor’s bankruptcy. If the franchisor is the lessee of the premises and subleases the premises to the franchisee, the franchisee may be able to retain possession under two separate theories. First, if the franchisor elects to reject the master lease, depending on state law, the rejection may not be treated as a termination and the franchisee/tenant may
have an independent right under state law to continue to occupy the property. Second, the
Bankruptcy Code allows a lessee to remain in possession of the leased premises for the
balance of the term if the debtor landlord rejects the lease. The balance of the term includes
any renewal or option periods. Therefore, the franchisee will not be deprived of its lease
rights for the term for which it bargained. The franchisee/tenant may offset the rent reserved
under the lease against damages caused by the rejection, but does not have any affirmative
rights against the bankruptcy estate for any damages after the rejection that result from the
rejection.

1. **Advantages**

An established franchisor will typically have access to more attractive spaces within
shopping centers, will be presented with more deals, and will be able to negotiate more
favorable lease terms than a single-unit operator. System franchisees benefit from the financial
strength of the franchisor, its operational history and the landlord’s knowledge that the
franchisor believes so strongly in its system that it is willing to assume lease liabilities. The
franchisee may wind up with a better site than it could have obtained on its own, with better
economic and legal terms. The franchisor also benefits in a number of ways. As sublandlord, it
is better able to monitor the financial health of its franchisee. Instead of relying on an
independent landlord for information on late or non-payments, the franchisor learns directly of
any problems. Warning signs of distress will be received sooner. Further, a franchisor, as
sublandlord, will be able to take possession of the unit following default under the lease or
franchise agreement by eviction, if necessary.

In a franchisee’s bankruptcy filing, the franchisor will have more control in the process. It
has the option of extending the assumption/rejection period for the lease, or not. It need not be
dependent upon the landlord’s willingness to honor the Lease Rider. Finally, instead of hoping
for a cooperative landlord to work with the franchisee in structuring a payment plan over time,
the franchisor, as sublandlord, has the option of helping the financially troubled franchisee with
financial assistance.

2. **Disadvantages**

Real estate leases are expensive. When computing base rent, additional rent and
security deposits for many sites, the cumulative costs can be very high. Capital is often tight
and may be one of the reasons the franchisor chose franchising as a method of distribution in
the first place. It may not have the resources to enter into leases itself. Entering into leases
creates contingent liabilities, which negatively impact the franchisor’s financial statements.

The franchisor who subleases is assuming a greater risk of liability in connection with a
franchisee’s operation of the franchised business due to (1) an arguably greater degree of
control over the franchised business’ operations and, thus, vicarious liability claims for the
franchisee’s liabilities, (2) non-payment of rent or other monetary obligations, and (3) statutory

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18 A tenant electing to remain in the premises is not required to remain throughout all possible renewal periods
or to exercise all of its renewal options at the time the tenant elects to remain in possession. In re Flagstaff Realty
Assocs., 60 F.3d 1031 (3d Cir. 1995).
19 This is especially so where there is a reporting requirement under a percentage rent arrangement. The
franchisor can compare the gross sales reports delivered under percentage rent reporting to the gross sales reports
under royalty reporting.
liabilities associated with being a landlord/tenant of real property (for example, liabilities under the Comprehensive Environmental Response, Compensation and Liability Act, state environmental statutes, and the Americans with Disabilities Act).

These risks can be reduced by having a dedicated affiliated leasing company execute the lease instead of the franchisor acting as sublandlord. However, (1) certain of the benefits of the franchisor signing the lease (such as greater financial capability and greater leverage) would not be available and (2) it is important that the franchisor not misrepresent the actual party on the lease.\textsuperscript{20}


Although not always the case, under most circumstances the franchisor would negotiate the terms of the master lease and, due to its greater experience and possibly leverage, it could extract better lease terms (such as a dollar or percentage cap on CAM, a cap on annual CAM increases, a narrower definition of expenses included in CAM and an exclusivity clause) than a franchisee could. (Of course, it could utilize that experience and leverage even if the franchisee were signing the lease.)

Depending upon the franchisor’s leverage, the master lease may include the right for the franchisor to sublease the premises to either a specified franchisee, a franchisee who meets certain criteria or any franchisee selected by the franchisor.

The franchisor desires to minimize its exposure under the master lease once it has subleased the premises to the franchisee. Depending upon the respective leverage of the franchisor and the landlord, the landlord may agree that the franchisor’s liability under the lease will be either subordinate to the franchisee’s and its principals’ obligations to the landlord and/or limited to a stated dollar amount or a number of months of rent.

The franchisor may have a “chicken and egg” problem with respect to the master lease and the franchise agreement. The franchisor may want to tie up a valuable site for the operation of the franchised business although it has not yet located a franchisee interested in operating the franchised business at that site. Therefore, it may execute the master lease and seek to sublease it to a franchisee after it has located that franchisee.


A lease can be transferred by the lessee in one of two ways: by assignment or sublease. The formal distinction between an assignment and a sublease is based on the difference in what each transfers.\textsuperscript{21} An assignment is a transfer by a tenant of its entire interest in the lease, whereas a sublease is a transfer of something less than the tenant’s full interest.\textsuperscript{22}

When a lease is transferred by assignment, the assignee steps into the lessee’s shoes and acquires all the lessee’s rights in the

\textsuperscript{20} See OTR Assocs. v. IBC Servs., Inc., 801 A.2d 407 (N.J Super. Ct. App. Div. 2002) where the New Jersey Appellate Division found that it was appropriate to pierce Blimpie International’s leasing subsidiary’s corporate veil to hold the parent company liable for rent because the true identity of the tenant was not made clear to the landlord. The tenant was actually a leasing shell entity. The court determined that the landlord was misled to believe that the tenant was the Blimpie franchisor.

\textsuperscript{21} Milton R. Friedman & Patrick A. Randolph, Jr., Friedman on Leases, § 7:4.1, at 7-83 (5th ed. 2006).

\textsuperscript{22} \textit{Id.}
lease. Privity of estate ends between the lessor and lessee and is created between the lessor and the assignee. The assignee therefore becomes bound by the covenants running with the land. Privity of contract between the lessor and lessee, however, does not end by the mere assignment of the lease and the lessee is therefore still bound by the lease provisions. On the other hand, when a lease is transferred by sublease, a new lessor-lessee relationship is created between the original lessee and the sublessee. The original lessee retains both privity of estate and privity of contract with the original lessor and no legal relationship is created between the lessor and the sublessee.\footnote{Italian Fisherman, Inc. v. Middlemas, 545 A.2d 1, 4 (Md. Ct. App. 1988) (emphasis added).}

Typically, but not always, the franchisor will sublet the leased premises, as opposed to assigning the lease to the franchisee. Assignment will divest the franchisor of privity and therefore direct control of the leased space. On the other hand, an assignment and release will relieve the franchisor of continuing liabilities. The sublease will be subject and subordinate to the master lease and the franchisee will agree to comply with the terms and conditions of the master lease. In addition, there will be a broad indemnity of the sublessor by the franchisee. Delivery of the subleased premises from the franchisor to the franchisee will be without warranty and in “as is” condition to franchisee. The sublease will terminate upon the expiration or termination of the master lease. The sublease also gives the franchisor another chance at disclaiming its involvement in the site selection process (e.g., “sublessee has selected the site and requested that the franchisor/sublessor enter into a lease with prime landlord”) to further shield itself from bad site selection claims. The franchise-specific provisions are (1) a narrow use clause so that the only permitted use is operation of the franchised business; (2) no right to further assign or sublet without the franchisor’s consent; (3) no alterations or renovations without the franchisor’s consent; (4) the franchisor’s right to gain access freely; and (5) a negative representation on the suitability of the site for the sublessee’s business.

The franchisor may pass on the security deposit, rent and CAM charges as they exist under the master lease or may increase them in an attempt to cover administrative costs in entering into and maintaining the master lease.

The franchisor may require that rent and CAM charges be paid to either the franchisor (which will pass them on to the landlord) or directly to the landlord. The former obviously provides the franchisor greater protection in the event of the franchisee’s financial difficulties and the latter obviously provides the franchisee greater protection in the event of the franchisor’s financial difficulties.

The sublease and the franchise agreement should provide for cross default. A default under one will be a default under the other, giving rise to a host of remedies to the franchisor, including termination and the right to possession of the leased premises. Courts typically uphold such a cross-default provision.\footnote{See American Vision Ctr. of St. Louis, Inc. v. Carr Optical, Inc., 810 S.W. 2d 121 (Mo. Ct. App. 1991).} Some franchisors use cross-default provisions to file a dispossession or eviction action to avoid an arbitration action, which may be required by the franchise agreement’s dispute resolution provision. A summary dispossession action may limit counter-claims and affirmative defenses, as they are often limited to issues relating only to possession.

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\footnote{Italian Fisherman, Inc. v. Middlemas, 545 A.2d 1, 4 (Md. Ct. App. 1988) (emphasis added).}

\footnote{See American Vision Ctr. of St. Louis, Inc. v. Carr Optical, Inc., 810 S.W. 2d 121 (Mo. Ct. App. 1991).}
A sample of a franchisor-friendly Sublease is attached as Appendix 3.

III. Bankruptcy Issues

In a franchisee bankruptcy filing, the party controlling both the real estate and the business operations will usually exercise a great deal of control in the bankruptcy process. Therefore, a franchisor who is also the lessor or sublessor of its franchisee’s premises is in a more favorable position than the franchisor who merely relies upon a collateral assignment to enforce its rights. Under the Bankruptcy Code, being the landlord under a non-residential lease of real property has distinct advantages. When the franchisor is both the landlord and the licensor of the franchised system, it can exercise control over the timing and potential outcome of the bankruptcy process. Under the 2005 amendments to the Bankruptcy Code, a debtor/tenant now has a maximum of 210 days (120 days, plus an optional 90-day extension for cause) to assume or reject non-residential real property leases. This time period may not be extended without the landlord’s prior written consent, which may be granted or denied in the landlord’s sole discretion. Prior to assumption or rejection of the lease, the debtor/tenant is required to timely perform all obligations under the lease during the pendency of the bankruptcy case. In order to assume the lease, the debtor/tenant is required to cure any defaults under the lease, compensate the landlord for any actual losses caused by prior defaults and provide adequate assurance of future performance. Where there are cross-default provisions between the sublease and the franchise agreement, these requirements may be applicable to obligations under the franchise agreement as well.

In contrast, in the case where there is an unrelated landlord and the franchisor merely has the right to take an assignment of the lease, the controls that would be available to the franchisor are exercised by an unrelated third party landlord. Unlike a non-residential real estate lease, the time period for assumption of a franchise agreement may be extended until confirmation of the plan, a period likely to be greater than 210 days. Further, the franchisee may seek to assume the lease, but reject the franchise agreement. In such a case, the franchisor would seek enforcement of its rights under the collateral assignment or Lease Rider, which should state that upon termination, the franchisor has the right to exercise its right to take an assignment of the lease. There is a split in authority on whether the rejection of an executory contract is tantamount to termination. If the collateral assignment or Lease Rider states that the franchisor’s rights are triggered on termination, unless the landlord takes affirmative action to terminate the lease, the franchisor may be unable to exercise its assignment rights in a jurisdiction that does not consider rejection to be tantamount to termination. Further, the franchisor may have to take additional action to enforce the post-termination requirements in the franchise agreement to ensure a proper de-imaging and enforce non-competition rights. However, it will be more difficult for a franchisee to attempt to reject the franchise agreement and assume the lease in a shopping center context, if the collateral assignment specifically limits the use of the premises to operation of a XYZ Franchised Store.

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28 Id. § 365(d)(3).
29 Id. § 365(b)(1).
31 Bankruptcy courts must now enforce use restrictions in shopping center leases under the 11 U.S.C. § 365(b)(3). This change in the 2005 amendments overrules a line of case law which found that use restrictions in
restriction in a shopping center lease, the franchisee will be limited to the option of assigning to an approved system franchisee or the franchisor and, therefore, would probably not attempt to assume the lease without also assuming the franchise agreement.

Another advantage of a franchisor being the sublessor (as opposed to relying on a collateral assignment or Lease Rider) is that when the franchisee rejects the lease, the third party landlord may not honor the collateral assignment affixed to the rejected lease -- for legitimate reasons or for no reason. A landlord may argue that the lease was rejected and terminated, and therefore, the whole agreement is terminated without any surviving rights. The franchisor will argue that there was independent consideration and contractual obligations between the franchisor and the landlord; that the purpose of the collateral assignment was to ensure that franchisor has an option to take the lease upon default. Under this scenario, it is especially important that both the landlord and the franchisor sign the collateral assignment document to establish privity of contract, in addition to the existence of the implied rights of the franchisor as a named third party beneficiary.

Before a franchisee can assume a lease or a franchise agreement, it needs to cure all defaults and provide adequate assurance of future performance. As the sublessor, the franchisor will be able to directly participate in that analysis as it relates to the sublease. However, where there is an independent landlord, the franchisor will probably not be able to participate in the determination of whether the franchisee/tenant has provided adequate assurance of future performance as a prerequisite to the assumption of the lease. An exception may be where there is a cross-default provision in the franchise agreement (i.e., a default under the lease is a default under the franchise agreement). In that case, the franchisor may have standing on the issue of whether the tenant may assume the lease, along with the third party landlord. Certainly, the franchise agreement can create an independent contractual obligation to satisfy the franchisor that the franchisee can adequately perform under its location lease.

IV. Site Selection Issues

The franchisee has “the chicken and the egg” timing problem with respect to the franchise agreement and the lease. On the one hand, the premises selection and the lease terms are subject to the franchisor’s approval; on the other hand, the franchisee typically must select an appropriate site, sign an acceptable lease and commence the franchised business’ operations by the deadlines contained in the franchise agreement. Otherwise, the franchisee’s franchise fee, as well as other expenditures, may be lost.

Most franchisors attempt to limit their exposure to claims from franchisees that the franchisors selected sites for franchisees’ locations, which contributed to the failure of the franchisees’ franchised businesses, by requiring franchisees to select their own sites, but reserving the franchisor’s right to approve or disapprove the site. To further insulate the franchisor from liability, the franchise agreement and the Franchise Offering Circular (soon to be the Franchise Disclosure Document) should clearly state that set of facts and expressly disclaim any representation or warranty of success arising out of the franchisor’s approval of the franchisee’s site.

shopping center leases held by a debtor are an improper restriction on free assignability, thus decreasing the value of the estate. This rule does not necessarily apply in non-shopping center leases. The Bankruptcy Code does not, however, define the term “Shopping Center.”

32 Again, a bankruptcy court may not deem the rejection to be a termination, thus clouding the issue of whether a franchisor has enforceable rights under the Lease Rider.
At times, the documents pay lip service to this issue, regardless of the fact that the franchisor or its broker referred the franchisee to the site (or even has the site already tied up under a master lease). Where the franchise documents state one thing and the franchisor acts in an inconsistent manner, it exposes itself to liability.

For example, in *J&R Ice Cream v. California Smoothie*, the franchise agreement specified that the franchisee was to negotiate a lease after franchisor approval of the site selection. Both the Franchise Agreement and Site Selection Agreement in essence granted the franchisee the right to obtain a franchise to establish and operate a restaurant if it identified a specific location for the restaurant within the Assigned Area and obtained the franchisor's approval of the site. The Site Selection Agreement also provided that within 30 days of the franchisor's approval of the site, the franchisee must negotiate a lease for the site and that the lease must be approved in writing by the franchisor. Finally, Site Selection Agreement provided that upon request from the franchisee, the franchisor will provide “any additional guidelines and reasonable site selection assistance and counseling.” Therefore, the franchisee was contractually responsible for proposing a site, while the franchisor retained the right to reject the proposed site based on certain criteria identified in the agreement. The Site Selection Agreement did not impose a duty on the franchisor to select a site for the Franchisee or to negotiate a lease for their site.

The franchisor, however, selected and leased the site, with the intent to sublease it to a prospective franchisee. The franchisor specifically made reference to the site in its discussions with the plaintiff. In addition, the evidence indicated that the franchisor made a deliberate decision not to include the franchisee in negotiations for the lease. Prior to executing the agreements, the franchisee expressed concerns that the lease negotiated by the franchisor did not contain a cap on common area maintenance fees. The franchisor’s guidelines indicated that common area maintenance fees for a food court should not exceed two percent of gross sales. The franchisor responded to this concern by stating that it had reached an oral agreement with the landlord providing that common area maintenance fees would not exceed three percent of gross sales. In reality the fees totaled more than the promised three percent. As a result, the franchisee sued the franchisor alleging, among other things, that the franchisor was negligent in its selection of the location and its negotiation of the lease.

The Court reasoned that where a relationship is “essentially contractual in nature,” a party may be “subject to a negligence action if the ‘act complained of was the direct result of duties voluntarily assumed ... in addition to the mere contract.” Here, the site selection and lease negotiation processes did not follow the pattern described in the Site Selection Agreement and the franchisor conceded that it already had selected the site and negotiated a lease prior to the execution of the Site Selection Agreement. The Court concluded that the franchisor assumed a duty to select the site for the franchisees and to negotiate the lease for them. As a result, the Court held that the franchisor was liable to the franchisee for negligently breaching that duty.

Another example of disregarded guidelines is *TCBY Systems, Inc. v. RSP Co.*, where the franchisor disregarded its own stated demographic guidelines when it approved a franchisee-selected store site. The court found that bad motive existed because the site fell “woefully short” of the franchisor’s own documented guidelines. The franchisor employee who

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34 Id. at 1275.
35 TCBY Sys., Inc. v. RSP Co., 33 F.3d 925, 928 (8th Cir. 1994).
36 Id. at 928.
evaluated franchisee’s proposed sites was a manager without previous experience in conducting site evaluations. To make matters worse, the franchisor had demographic reports showing that the location failed to meet the franchisor’s minimum guidelines for site approval. As this case illustrates, it is advisable to encourage and require the franchisee to make its own decision whether to select the particular site as the premises upon which it will operate the franchised business, rather than to pressure the franchisee to utilize the particular site because the franchisor requires it.

Oftentimes experienced and well-funded franchisors are selling not just the franchise system and product, but also their ability to select and gain access to the most desirable sites. With employees or independent contractors (frequently brokers) whose purpose it is to seek out and tie up desirable sites, as well as off-the-shelf or custom, proprietary demographic software, the franchisor is usually in a better position than the franchisee to perform site selection analyses and gain access. However, if franchisors undertake the responsibility to select sites for franchisees’ locations and if the franchised businesses at those locations fail, the franchisors could be subject to liability based upon arguably poor selections and/or the failure to follow their own specified guidelines.

V. Franchisors and Vicarious Liability

Generally, a franchise relationship does not, in and of itself, give rise to vicarious liability. However, the perception of the franchisor as the “deep pocket” behind the franchisee and the lack of clarity and consistency among the cases addressing the issue encourage plaintiffs and their attorneys to name franchisors as defendants in plaintiffs’ lawsuits seeking recovery for franchisees’ acts and omissions.

One of the key elements in vicarious liability is the presence of a legally sufficient relationship between the person who caused the plaintiff’s injury and the vicariously liable defendant. Actual agency is typically the basis for satisfying the legally sufficient-relationship requirement; however, some courts apply the principle of apparent agency in lieu of, or as an exception to, the legally sufficient-relationship requirement.

In determining whether to impose vicarious liability upon a franchisor for a franchisee’s act or omissions based upon the principle of actual agency, courts will generally examine the nature and extent of the franchisor’s control, or right to control, the franchisee in its day-to-day operation of the franchised business, rather than the uniformity and standardization of the products and services. Courts differ on whether the relevant analysis is the franchisor’s control over the entire franchised business, the aspect of the business causing the injury or the franchisee. Courts generally look at the entire agreement and the relationship between

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39 Id. at 429-430.
42 Kerl at 682 N.W. 2d 328, 341
the franchisor and the franchisee to determine the extent and nature of the franchisor’s control, or right to control, the franchisee’s operations.\footnote{44}{Butler v. McDonald’s Corp., 110 F. Supp. 2d 62 (D.R.I. 2000) (sending issue of whether agency relationship exists to jury).}

In determining whether to impose vicarious liability upon a franchisor for a franchisee’s act or omissions based upon the principle of apparent agency, two elements are critical: (1) that the franchisor created the appearance of an agency relationship between the franchisee and the franchisor and (2) that the plaintiff detrimentally relied upon the existence of an agency relationship.\footnote{45}{Sims v. Marriott Int’l., Inc., 184 F. Supp. 2d 616, 617 (W.D. Ky. 2001).}

A franchisor’s imposition of lease terms through a Lease Rider is an element of control over the franchisee, the franchised business and, if the injury at issue relates to the franchised premises, over the aspect of the business causing the injury. Therefore, a franchisor’s imposition of lease terms through a Lease Rider could contribute to a finding that the franchisor is vicariously liable for the injury caused by a franchisee’s act or omission.

A franchisor’s lease of premises from the landlord and subsequent sublease of the premises to the franchisee grants the franchisee a greater degree of control over the franchisee, the franchised business and, if the injury at issue relates to the franchised premises, over the aspect of the business causing the injury. Therefore, a franchisor’s lease and sublease of the franchised premises could contribute to a greater extent to a finding that the franchisor is vicariously liable for the injury caused by a franchisee’s act or omission.

If the relevant analysis is the control over the franchisee or the franchised business, the franchisor’s imposition of lease terms through a Lease Rider or the franchisor’s lease and sublease of the franchised premises would merely be one factor among others that a court would consider. If, however, the relevant analysis is the control over the aspect of the business causing the injury, and the injury relates to the franchised premises, a franchisor’s imposition of lease terms through a Lease Rider or the franchisor’s lease and sublease of the franchised premises would be more likely to result in a finding of vicarious liability against the franchisor.

VI. Practical Aspects of Transitioning Out Poor Operators

Where the franchisor has a direct interest in the leased premises by sublease, it will be in a stronger position to transition failed franchisees out of the space and the franchised system. It starts with being better able to recognize the warning signs. Rental payments and sales reporting to the franchisor, as landlord, will provide additional monitoring of the franchisee’s financial health. When problems do arise, the franchisor will have the option of implementing a payment plan for rent, which it might not be able to do if rent is paid directly to an unrelated landlord. If the result is that the franchisee must exit the system, the direct landlord/tenant relationship gives the franchisor the right to commence an eviction action. As discussed in Section III, there are additional benefits of controlling the real estate in the bankruptcy context. Furthermore, as landlord, the franchisor may have a state statutory lien on the tenant’s personal property.

However, evicting a sublessee results in the franchisor being liable for continuing rental obligations to the landlord. The franchisor should consider coordinating the timing of eviction and termination with the insertion of a new operator into the unit. Otherwise, the franchisor is both operating the unit and making the rental payments. As a practical matter, the franchisor
should avoid stepping into the operational chain and running the unit, especially if it intends to re-franchise the location. By inserting itself into the chain, it creates exposure for a host of liabilities. These include taxes and creditor claims under successor liability theories and environmental claims under operator liability theories. If the plan is to insert a new operator, the best advice is to transition from one operator to the next, and skip the interim step of having the franchisor operate in between the two.

VII. Conclusion

Successful franchisors work hard to maintain a level of control over valuable leased franchised locations. Through the use of a Lease Rider or a collateral assignment of lease, it will either negotiate directly with the landlord or indirectly through its franchisee for the provisions it deems most important. Some Lease Rider provisions are expendable - nice to have, but not essential - while others are imperative. Since the interests of the franchisor, franchisee and landlord, and sometimes the franchisee’s lender and landlord’s lender, diverge in these transactions, the resulting form of lease agreement will be determined by the parties’ respective leverage and advocacy skills. The challenge for the franchisor is determining which provisions are expendable and which are essential, and at what point does it pass on a location because the essential provisions are rejected by the landlord. Most franchisees are more reactive than proactive in their relationships with the landlord. The franchisee is beholden to its franchisor and perhaps a lender. It is often advocating hardest for a party other than itself. The challenge for the franchisee is to sign a fair lease, in short order, that satisfies the requirements of its franchisor and, if applicable, its lender. Landlords seeking to attract franchised brands will be flexible in negotiating their leases and will permit insertion of many of the Lease Rider provisions. Their goals are to achieve a good mix of quality tenants who pay their rent on time and attract customers to the center. The challenge for the landlord is to ensure that it has a quality operator with the financial wherewithal to meet its rent obligations. If that operator fails or is terminated, the landlord needs to know that the franchisor will stand behind the unit and make the landlord whole by operating the unit as a company-owned store or by refranchising it to a known, quality franchisee. Each party’s objectives are valid and deserve consideration.
Appendix 1 – Sample Provisions

Use of Marks

“Landlord consents to Tenant’s use and installation of the marks, trade dress, signage and related features associated with the franchised system that Franchisor may prescribe from time to time.”

Remodel Rights

“Tenant shall have the right to remodel, modify, paint and make installations in the interior of the leased premises as may be required by Franchisor from time to time, including without being liable under any continuous operation covenant.”

Use Clauses

“The Leased Premises may only be used for the operation of [the franchised business] and for no other purpose.”

Use Approval

“Landlord represents that Tenant may operate the Leased Premises as [the franchised business] without violating any applicable law or another tenant’s exclusive use provision.”

Notice and Opportunity to Cure

“Landlord shall deliver to Franchisor copies of any and all letters or notices sent to Tenant relating to the Tenant or the Leased Premises at the same time that such letters or notices are sent to Tenant. In the event that the notice or letter is a default letter, and Tenant fails to timely cure such default, Landlord shall deliver to Franchisor written notice of such failure to timely cure. This notice to Franchisor shall be a prerequisite for the Landlord’s exercise of any remedies resulting from the default. Franchisor shall have a ten (10)-day period (or a reasonable period of time to cure a non-monetary default not capable of being cured within such ten (10)-day period) following receipt of such written notice to cause a cure of Tenant’s default. Franchisor shall have the option, and not the obligation, to effect a cure, in advance of Landlord exercising any remedies. Franchisor’s election to cure shall not be deemed an election to assume the Lease, unless and until Franchisor expressly does so in writing.”

Lease Assignment

“Tenant hereby assigns its rights under the lease to Franchisor, and Landlord hereby consents to such assignment subject to the following conditions: One of the following shall have occurred: (a) Tenant fails to timely cure a default under the lease; or (b) Tenant fails to exercise a renewal option under the Lease; or (c) Tenant fails to timely cure a default under the Franchise Agreement; and Franchisor sends written notice to Landlord that Franchisor is exercising its right to accept the assignment of Tenant’s rights under the Lease; and Franchisor cures Tenant’s default, as applicable, within ten (10) days of written notice of default to Franchisor; provided, however, any monetary default cure amount shall be limited to an amount equal to two months’ Rent. Landlord acknowledges that by executing this Rider, Franchisor does not hereby assume any liability with respect to the Leased Premises or any obligation as
Tenant under the Lease, unless and until Franchisor expressly assume such liability as described above.

**Refranchising**

“At any time following Franchisor’s election to take an assignment of Tenant’s rights under the Lease, Franchisor may, on written notice, assign the Lease or sublet the Leased Premises to an affiliate of Franchisor or a franchisee approved by Franchisor, without charge or penalty, so long as such assignee or sublessee meets Landlord’s reasonable financial qualifications. Upon an assignment, Franchisor shall be released from any further obligations under the Lease. Landlord agrees to execute written documentation confirming any such assignment and release.

**No Amendment**

“Tenant and Landlord agree that they will not renew or extend the term of the Lease, without Franchisor’s written consent. Tenant and Landlord agree that they will not amend, modify, or alter any other Lease term without Franchisor’s written consent.”

**No Other Assignment or Subletting**

“Tenant may not assign its interest in the Lease, nor sublet all or any portion of the Leased Premises, without Franchisor’s written consent.”

**Access to Protect the Franchise System**

“Franchisor shall have the right to cause a de-image of the Leased Premises by entering to make any modifications to protect the franchised system, as to be determined by Franchisor in its sole discretion, without being guilty of trespass or liable for any tort. Franchisor agrees repair any damage to the structure of the property caused by such entry. Tenant shall remain liable to reimburse Franchisor for the costs of such de-identification.”

**Rider Supersedes**

“Landlord acknowledges that Franchisor is not a party to the Lease. However, Franchisor is intended to be a third party beneficiary of the Lease Rider with an independent right to enforce its terms against Landlord and Tenant. Landlord and Tenant hereby waive any claim that Franchisor has no right to enforce the Lease Rider.”
FOR AND IN CONSIDERATION of the sum of Ten and No/100 Dollars ($10.00) in hand paid to the undersigned and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the undersigned (hereinafter referred to as "Landlord") executes this Landlord's Consent Estoppel and Waiver in favor of ________________.

1. Landlord represents that it is the owner of the Premises, as same are described in the Lease.

2. Landlord represents that the Premises are leased in accordance with, and are subject to, the Lease with ________________ (the "Borrower") pursuant to the Lease and that, as of this date to the best of Landlord's knowledge, Borrower is not in default under any terms of the Lease. Landlord confirms that the Lease expires on ________________.

3. Landlord acknowledges and consents to the fact that Borrower has granted to Lender a security interest in and to all of Borrower's furniture, moveable trade fixtures, signage, equipment and other personal property (whether or not any of the foregoing collateral becomes so related to the real estate that an interest therein arises under real estate law) (all of which is referred to hereinafter the "Collateral") which are presently located or may at any time hereafter be located in, at or upon the Premises, and pledged its leasehold interest in the Property pursuant to the Lease to Borrower pursuant to a Leasehold Deed of Trust and a Collateral Assignment of Lessee's Interest in Lease, as collateral in connection with a loan (the "Loan").

4. Until such time as the liabilities of Borrower to Lender are paid in full, Landlord:

   (a) Disclaims any interest in such Collateral which is now or hereafter located in, at or upon the Premises; and

   (b) Agrees to subordinate any and all of Landlord's rights, title, interest, claims or liens by Landlord to all liens of Lender until said liabilities have been paid in full.

5. Landlord agrees not to interfere with any enforcement by Lender of Lender's rights in and to the Collateral, and agrees to permit Lender access to the Premises and any other premises owned or leased by Landlord at which the Collateral may be located at any time, and from time to time, in order to exercise Lender's rights. Landlord agrees not to interfere with any sale of the Collateral, by public auction or otherwise, conducted by or on behalf of Lender on the Premises.
6. Landlord agrees to permit Lender to remove the Collateral from the Premises, and from any other premises at which the Collateral may be found, without any liability upon Lender, except that Lender shall promptly repair, at Lender's expense, any physical damage to the Premises actually caused by said removal by Lender. Landlord shall not be responsible for the removal of the Collateral from the Premises. Lender shall not be liable for any diminution in value of the Premises caused by the absence of the Collateral actually removed or by any necessity of removing the Collateral. Upon Landlord's written notice to Lender, Lender shall have twenty (20) days from the date of said notice remove the Collateral from the Premises all as more fully set forth in Paragraph 8 herein.

7. In the event Borrower has ceased making payments due to Landlord on account of the Premises, if Lender desires to remove the Collateral and not assume the lease pursuant to Paragraph 9 hereinbelow, Lender shall pay to Landlord, the rental provided in the Lease for the use and occupancy of the Premises from the date on which Lender shall have taken possession of the Collateral until the date of any such sale of the Collateral, it being understood, however, that Lender shall not thereby have assumed any of the obligations of Borrower to Landlord under the Lease or otherwise, all of which shall remain the obligation of Borrower, and it being further understood that the removal of the Collateral shall be completed within Twenty (20) days.

8. If Landlord intends to terminate the Lease for Borrower's default thereunder, Landlord agrees to provide Lender with written notice of any such default or claimed default under the Lease at the address hereinafter provided, and prior to the termination of the Lease, will permit Lender the same opportunity to cure or cause to be cured such default as is granted to Borrower under the Lease; provided however, that the Lender shall be under no obligation to remedy such default. Notwithstanding the foregoing, if the Lender remedies such default in the manner permitted and provided under the terms of the Lease and this Landlord's Estoppel and Waiver, Landlord agrees not to terminate the Lease due to such default, but instead agrees to allow Lender or its designee to assume the rights and obligations of the Lease pursuant to an Assignment and Assumption of Lease Agreement which is in form reasonably acceptable to Landlord, Lender and its designee. Lender's designee shall be an entity experienced in the operation of the restaurant business and shall be a franchisee of a nationally recognized franchisor and shall use the Premises only for the purposes provided for in the Lease.

9. Landlord agrees that the name of the Lender may be added to any and all insurance policies required to be carried by Tenant hereunder.

10. Check one of the following:
   • _____ Landlord hereby represents that ________________________________ (the "Fee Lender") has a lien against Landlord’s fee interest in the Premises. Landlord hereby gives Lender permission to contact such Fee Lender.
   • _____ Landlord hereby represents that the real property is not encumbered by a Deed of Trust or Mortgage.

11. The undersigned Landlord has the full power and authority to execute this Landlord's Estoppel and Waiver.

12. This Landlord’s Estoppel and Waiver shall inure to the benefit of Lender, its successors and assigns, shall be binding upon Landlord, its successors and assigns.
Signed, sealed and delivered this ____ day of ________________, ______.

LANDLORD:

By:__________________________________________
Name:
Title:

(ADD NOTARY FOR STATE WHERE PROPERTY IS LOCATED)
Appendix 3 - Sample Sublease

SUBLEASE

Sublease (this “Sublease”), dated as of the date set forth in Exhibit A attached hereto (the “Effective Date”), by and between “Sublessor”, and the sublessee identified in Exhibit A to this Sublease (“Sublessee”).

WHEREAS, Sublessor, as tenant, previously entered into, or intends to enter into, that certain lease (the “Lease”) in the form of Exhibit B attached hereto, pursuant to which Sublessor leases certain premises (the “Premises”) as described in the Lease from the landlord under such Lease (“Landlord”);

WHEREAS, Sublessor and Sublessee have entered into that certain Franchise Agreement for [franchise system] Unit No. ______ (the “Franchise Agreement”);

WHEREAS, pursuant to the Franchise Agreement, the parties intend that Sublessee will establish and operate a [franchise system] unit within the geographical area identified in the Franchise Agreement;

WHEREAS, Sublessee has selected the Premises for the location of the [franchise system] unit to be established and operated by Sublessee;

WHEREAS, in accordance with the Franchise Agreement, Sublessor desires to sublease to Sublessee, and Sublessee desires to sublease from Sublessor, the Premises and Sublessor’s rights in the Premises pursuant to the Lease, upon the terms and conditions contained herein;

NOW, THEREFORE, in consideration of the foregoing premises, the execution and delivery of the Franchise Agreement by Sublessor and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged by the parties, Sublessor and Sublessee hereby agree as follows:

1. Agreement to Sublease. Sublessor hereby demises and sublets to Sublessee the Premises, together with all rights, privileges and appurtenances related to the Premises, and Sublessee takes from Sublessor, the Premises, for the Term (as defined herein). If this Sublease is executed prior to the mutual execution and delivery of the Lease, then Sublessor’s obligations hereunder will be contingent upon the mutual execution and delivery of a fully-executed Lease within 90 days after the date of this Sublease. If Sublessor has not received a fully-executed Lease within 90 days after the date of this Sublease, then either Sublessor or Sublessee may terminate this Sublease upon 10 days’ prior written notice to the other at any time prior to the mutual execution and delivery of the Lease.

1.1 Assumption. Sublessee assumes, and agrees to abide by, all terms and conditions of the Lease with respect to the Premises, and agrees to faithfully perform all obligations required thereunder to be performed by Sublessor during the Term to the extent the same have not been fully performed by Sublessor as of the date hereof (including without limitation, any initial construction obligations).

1.2 Compliance with Lease. Notwithstanding anything to the contrary contained herein, the terms of this Sublease and Sublessee’s use, occupancy, maintenance, repair and
restoration of the Premises are subject and subordinate to the terms, covenants, conditions, agreements and requirements of the Lease. Sublessee must not commit or permit to be committed on the Premises any act or omission that will violate any term or condition of the Lease. To enforce the rights of Sublessor hereunder, Sublessor may exercise any and all remedies available to Landlord under the Lease, in addition to any other remedies provided hereunder or available at law or in equity.

2. Term; Renewal Options.

2.1 Term. This Sublease will become effective on the Effective Date and will continue for the full term of the Lease, as the same may be renewed or extended from time to time pursuant to Section 2.2, minus one day (the “Term”).

2.2 Renewal Options. If the Lease contains renewal options, Sublessee may exercise such options in accordance with this Section 2.2, provided that as of the time of the giving of the Renewal Notice (as defined below), no event of default exists or would exist hereunder or under the Lease but for the passage of time or the giving of notice, or both. To exercise a renewal option, Sublessee must notify Sublessor in writing in accordance with Section 17 of Sublessee’s intent to exercise such option (the “Renewal Notice”) not more than 90 days, nor less than 60 days, before the date that Sublessor is required to notify Landlord pursuant to the Lease of its intention to exercise such option. Time is of the essence.

2.3 Failure to Timely Deliver Renewal Notice. If Sublessee does not deliver the Renewal Notice within the time period stated above, Sublessee’s right to exercise the renewal option pursuant to this Section 2 will automatically become null and void and of no further force or effect. Sublessee’s exercise of a renewal option, as evidenced by delivery of the Renewal Notice to Sublease within the time period stated above, will be irrevocable in all events. Upon receipt of the Renewal Notice within the time period stated above, Sublessor will undertake to renew the Lease for the applicable renewal term. Sublessee agrees to indemnify, defend and hold harmless Sublessor and the Indemnified Parties (as defined below) with respect to the exercise of the renewal term under the Lease.

3. Rent.

3.1 Payment of Rent. The first month’s Base Rent, the Security Deposit and the first monthly installment of estimated Operating Expenses (as such terms are hereinafter defined) will be due and payable on the date hereof. Sublessee promises to pay to Sublessor in advance, without demand, deduction or set-off, regular installments of: (a) all base, minimum or fixed rent payable under the Lease (“Base Rent”), (b) any percentage rent or other rent based upon sales in, at, or from the Premises (“Percentage Rent”) and (c) any other payments payable under the Lease for operating expenses, common area expenses, taxes, insurance, utilities, marketing funds, merchants associations, sprinkler fees and any other costs and expenses, including, without limitation, any annual reconciliation(s) of the same (collectively, “Operating Expenses”), together with all sales, rental and privilege taxes due thereon. The foregoing costs are collectively referred to as “Rent.”

3.1.1 From and after the Effective Date, on the date 10 days prior to the date that Base Rent, Percentage Rent and/or any estimated Operating Expenses are payable to the Landlord, Sublessee must pay to Sublessor an amount equal to the amount due to the Landlord, including, without limitation, all applicable taxes thereon. To the extent that Sublessee has paid any amount in advance, Sublessee will not be obligated to pay the same for
the last month of the Term. To the extent that Percentage Rent paid or estimated Operating Expenses are not consistent with actual Percentage Rent Operating Expenses, the parties will adjust the amount on a monthly basis. Sublessee must also submit to Sublessor, together with each payment of Percentage Rent and estimated Operating Expenses, and each week until the following payment of Percentage Rent and estimated Operating Expenses, a sales report of Lease Gross Sales (as defined below) for the previous week in the form described in Section 3.2.

3.1.2 If requested by Sublessor, concurrently with Sublessee’s execution hereof or at any time thereafter, Sublessee must sign a pre-authorization enabling Sublessor to draw against Sublessee’s bank account for the full amount of the Rent and any other amounts due hereunder as and when the same become due. All Rent and other payments required to be made by Sublessee to Sublessor hereunder may be drawn against Sublessee’s bank account by Sublessor, or at Sublessor’s election, will be payable at such address as Sublessor may specify from time to time by written notice delivered in accordance herewith. Further, at Sublease’s option, Sublessor may direct Sublessee to make full or partial payments of Base Rent, Percentage Rent and/or Operating Expenses directly to Landlord, and Sublessee must immediately comply with such direction.

3.2 Sales Reports. Together with each payment of Percentage Rent and estimated Operating Expenses and each week until the following payment of Percentage Rent and estimated Operating Expenses, Sublessee must submit to Sublessor (and Landlord, if the Lease requires the delivery of sales reports) an itemized and accurate written statement signed by Sublessee or its duly authorized officer, setting forth in reasonable detail the full amount of Lease Gross Sales made during the preceding calendar month, and certifying to Sublessor (and Landlord, if applicable) that the same is true and correct. If the total amount of Percentage Rent paid by Sublessee for any week, month or calendar year during the Term (including the last calendar year of the Term) is less than the actual amount due from Sublessee for such period, Sublessee must pay to Sublessor the difference between the amount paid by Sublessee and the actual amount due upon demand, but in no event later than 15 days after the end of such calendar year; and if the total amount of Percentage Rent paid by Sublessee for any such week, month or year exceeds such actual amount due from Sublessee for such period, then such excess will be credited against the next installment(s) of Rent due from Sublessee to Sublessor under this Sublease, or promptly refunded to Sublessee if this Sublease has expired or otherwise terminated and Sublessee is not then in default hereunder. Upon three days’ notice to Sublessee, Sublessor or its representatives will have the right to conduct an audit of Sublessee’s books and records relating to Lease Gross Sales at the Premises at any time during the Term. If such audit reveals that Sublessee understated Lease Gross Sales, then Sublessee must pay to Sublessor the costs and expenses of the audit, together with Interest (as defined below) from the date Percentage Rent should have been paid hereunder and any interest, late fees or other penalties incurred by Sublessor under the Lease as a result of such underpayment. Sublessee must maintain all books and records relating to sales at the Premises for a minimum of three years. The obligations under this Section 3.2 will survive the expiration or sooner termination of this Sublease.

3.3 Lease Gross Sales. As used herein, the term “Lease Gross Sales” will mean the total gross sales in, on, from or originating within the Premises on which percentage rent, if any, is payable under the terms of the Lease or, if not defined therein, will mean Gross Sales (as defined in the Franchise Agreement).
3.4 **Late Charge.** Sublessee acknowledges that late payment by Sublessee to Sublessor of any rent or other payment due hereunder will cause Sublessor to incur costs not contemplated by this Sublease, the exact amount of such costs being extremely difficult and impractical to determine. Therefore, if Sublessee is delinquent in any installment of Base Rent, Percentage Rent, Operating Expenses or other sums due and payable hereunder for more than three days, Sublessee must pay to Sublessor on demand a late charge equal to five percent of such delinquent sum, plus any late charges and interest incurred by Sublessor under the Lease as a result of such late payment. The parties agree that such late charge represents a fair and reasonable estimate of the costs that Sublessor will incur by reason of such late payment by Sublessee. The provision for such late charge will be in addition to all of Sublessor’s other rights and remedies hereunder or at law and will not be construed as a penalty. In addition to the foregoing late charge, if Sublessee is delinquent in any installment of Rent or other payments due hereunder for more than 10 days, then such delinquent sum will bear interest at the rate of 18% per annum or the highest rate permitted by law, whichever is less (“Interest”), from the due date until paid in full.

4. **Security Deposit.**

4.1 **Cash Deposit.** Contemporaneously with Sublessee’s execution hereof, Sublessee must deposit with Sublessor or Landlord a security deposit in the amount set forth on Exhibit A (the “Security Deposit”). The Security Deposit will be held by Sublessor or Landlord as security for the performance of Sublessee’s obligations under this Sublease. The Security Deposit is not an advance rental deposit or a measure of Sublessor’s damages in case of Sublessee’s default. Upon each occurrence of an Event of Default hereunder (as defined below), Sublessor may use all or part of the Security Deposit to pay delinquent payments due under this Sublease or the Lease, and the cost of any damage, injury, expense or liability caused by such default, without prejudice to any other remedy provided herein or provided by law. Sublessee must pay Sublessor on demand, or Sublessor may draw on Sublessee’s bank account, the amount that will restore the Security Deposit to its original amount. Sublessor’s obligation with respect to the Security Deposit is that of a debtor, not a trustee; no interest will accrue thereon unless otherwise required by law. The Security Deposit will be the property of Sublessee, but will be refunded to Sublessee when Sublessee’s obligations under this Sublease have been completely fulfilled.

4.2 **Security Agreement.** Sublessee hereby grants Sublessor a security interest, and this Sublease constitutes a security agreement within the meaning of and pursuant to the Uniform Commercial Code of the state in which the Premises are located, in and to all of Sublessee’s property situated in or upon, or used in connection with, the Premises (except merchandise sold in the ordinary course of business) (collectively, the “Collateral”) as security for all of Sublessee’s obligations hereunder, including, without limitation, the obligation to pay Rent and other monetary amounts hereunder. Such property thus encumbered includes, without limitation, specifically all trade fixtures and any other fixtures removable by Sublessor, as tenant, pursuant to the Lease, inventory, equipment, signage, small wares, furniture, contract rights, accounts receivable and the proceeds thereof. Sublessee hereby irrevocably authorizes Sublessor to file such financing statements and other Uniform Commercial Code filings as Sublessor deems appropriate in order to perfect such security interest. Sublessee further agrees to execute such other financing statements as may from time to time be requested by Sublessor to further secure Sublessor’s interest under this Section 4.2 as often as Sublessor in its discretion may require.
5. **Utilities.** Sublessee must arrange for and pay for, prior to delinquency, the cost of any and all electricity, water, gas, sewer, telephone and other utilities consumed in the Premises commencing on the date Sublessee is permitted to access the Premises and continuing during the Term (collectively, "Utilities"), unless Landlord expressly pays for the same pursuant to the Lease and/or the cost thereof is paid by Sublessee as Operating Expenses. Such payments must be made directly to the utility provider unless the Lease provides otherwise. Notwithstanding the foregoing, Sublessor may elect to arrange for and/or pay the cost of such Utilities directly to the utility provider. If Sublessor so elects, then Sublessee must pay to Sublessor any and all amounts due for such Utilities upon demand. Sublessor may draw against Sublessee’s bank account from time to time for the full amount of the cost of such Utilities or Sublessee’s reasonable estimate of the costs thereof. Any failure to pay the cost of Utilities to Sublessor or any utility provider, as applicable, when due will be deemed a failure to pay Rent hereunder and will entitle Sublessor to exercise its remedies hereunder.

6. **Use.** Sublessee must use the Premises solely for the operation of a __________ in accordance with the terms and conditions of the Lease, this Sublease and all applicable federal, state and local laws, and for no other purpose whatsoever.

7. **Sublessor’s Obligations.** Subject to the terms of this Sublease, Sublessor is conveying to Sublessee only those rights to the Premises that it has acquired by virtue of the Lease. Sublessee acknowledges that the Lease sets forth certain Landlord obligations, which, as between Sublessor and Sublessee, Sublessor is not obligated to perform. Sublessee hereby waives and releases Sublessor from any and all claims Sublessee may now or hereafter have against Sublessor with respect to any and all such obligations and/or the contents of the Lease or any provision thereof (or Sublessor’s negotiation or documentation thereof), all of which have been read and approved by Sublessee. If Landlord fails to perform its obligations under the Lease, Sublessee must promptly send Sublessor written notice specifically describing the default in detail. Upon receipt of such notice, Sublessor will promptly notify Landlord of the alleged default. Sublessor will not be obligated to bring or defend any claim or action against Landlord and, if it declines to do so, Sublessee, at Sublessee’s sole expense, will have the right to do so, in which event Sublessee must indemnify, defend and hold harmless the Indemnified Parties against the same.

8. **Maintenance and Alterations.** Without limiting the generality of Section 1.1, Sublessee must maintain the Premises in good condition and repair and must perform all of “Tenant’s” maintenance, repair and replacement obligations under the Lease. Sublessee acknowledges that Sublessor will have no repair or maintenance obligations with respect to the Premises or the shopping center/development/project (the “Project”) in which the Premises is situated. Sublessee must not perform any construction or make any alterations, additions or changes to the Premises without Sublessor’s prior written consent and, if required by the Lease, Landlord’s written approval. Upon the expiration of the Term or the sooner termination of this Sublease, Sublessee must surrender the Premises in good condition and repair, in as good a condition or better than required at the time of Sublessor’s surrender under the Lease.

9. **Assignment and Subletting.** Without the prior written consent of Sublessor, which consent may be withheld in Sublessor’s sole and absolute discretion, (a) Sublessee may not assign, transfer, convey, pledge or mortgage this Sublease or any interest therein, whether by operation of law or otherwise, (b) no interest in Sublessee may be assigned, transferred, conveyed, pledged or mortgaged, whether by operation of law or otherwise, including without limitation, a merger or consolidation of Sublessee with another entity or the dissolution of Sublessee, and (c) Sublessee may not sublet all or any part of the Premises. No assignment of
this Sublease or subletting of the Premises consented to will relieve Sublessee of its obligations under this Sublease. Any assignment, transfer, conveyance, pledge, mortgage or subletting in violation of this Section 9 will be voidable at the sole option of Sublessor. Sublessee acknowledges that any assignment or subletting to which Sublessor may consent will be conditioned upon Landlord’s consent thereto, if Landlord’s consent is required under the Lease. Any assignment of this Lease or sublease of the Premises by Sublessee will be subject to the provisions of Section 6 above and the other provisions of this Sublease.

10. Risk of Loss. Except to the extent caused by the intentional misconduct of Sublessor and to the fullest extent permitted by law, (a) Sublessee assumes all risk of loss of or damage to Sublessee’s property located within the Premises or the Project, including, without limitation, any loss or damage caused by water leakage, fire, windstorm, explosion, theft, vandalism, earthquake, act of God or act of any other tenant or third party and (b) Sublessee waives any claim, demand and action against Sublessor for injury, death or property damage occurring in or around the Premises or Project during the Term.

11. Indemnification. To the fullest extent permitted by law, Sublessee hereby agrees to indemnify, defend (with counsel acceptable to Sublessor) and holds harmless Sublessor, and each of its officers, directors, affiliates, contractors, agents, attorneys and employees (collectively, the “Indemnified Parties”), for, from and against all claims, demands, damages, losses, causes of action and actions of any kind or nature whatsoever, and all related costs and expenses (including, without limitation, reasonable attorneys’ fees) (a) for injury, death, disability or illness of any person or damage to property occurring in or around the Premises or the Project or arising out of Sublessee’s use of the Premises or the Project, (b) in connection with or arising from the terms conditions, requirements and provisions of the Lease and this Sublease and (c) in connection with or arising from any mechanics’ or materialmen’s lien or claim filed against the Premises for work performed or materials furnished by or on behalf of Sublessee, except to the extent caused by the intentional misconduct of Sublessor. It is expressly agreed that Sublessee’s obligations under this Section 11 will survive the expiration or earlier termination of this Sublease for any reason.

12. Insurance. Sublessee must obtain such commercial general liability, property and other insurance coverages as Sublessor may reasonably request with respect to the Premises and/or the operation of Sublessee’s business in the Premises, but in no event less than the insurance coverage required to be carried by “Tenant” pursuant to the Lease (including, without limitation, loss of rent insurance, etc.). The insurance must be with companies reasonably acceptable to Sublessor, written on an occurrence basis, provide primary coverage and name Sublessor and Landlord as additional insureds or loss payees as their interests may appear, as applicable and as otherwise required of the “Tenant” under the Lease. The liability policy must contain a contractual liability endorsement. Such policies must provide that they may not be cancelled or materially changed in the scope or amount of coverage unless 30 days’ advance written notice is given to Sublessor and Landlord. Sublessee must deliver certificates evidencing the insurance required by this Section 12 upon the execution of this Sublease, annually thereafter and at such times as Sublessor may otherwise request.

13. Right to Inspect. Sublessor and its agents, employees or representatives will have the right to inspect the Premises during business hours to determine Sublessee’s compliance with the terms of this Sublease and the Lease.

14. Acceptance of Premises; Sublessee’s Representations. Upon the date that Landlord delivers possession of the Premises to Sublessor and Sublessor delivers possession of the
Premises to Sublessee (which may occur simultaneously), Sublessee agrees to accept the Premises in an “AS IS” condition, without representation or warranty of Sublessor. Sublessee represents and confirms to Sublessor that Sublessee has selected the Premises for the location of the [franchise system] unit to be established and operated by Sublessee and that: (a) no representative, agent, attorney or employee of Sublessor made any representations, inducements or promises about the Premises, the Lease or the entry into this Sublease; (b) no representative, agent, attorney or employee of Sublessor made any representations, inducements or promises about the characteristics or conditions regarding or pertaining to the Premises or the shopping center/development in which the Premises is situated; (c) Sublessee has independently investigated the potential for the success of its operations in the Premises and has not relied upon any representations, inducements or promises by Sublessor’s representatives, agents, attorney or employees; (d) Sublessee has concluded that the Premises has a reasonable opportunity for success as a [franchise system] unit; (e) Sublessee has inspected the Premises and finds the same in acceptable condition; (f) Sublessor has made no representation or warranty as to the suitability of the Premises for the conduct of Sublessor’s business; (g) Sublessee waives any implied warranty that the Premises are suitable for Sublessee’s intended purposes; (h) Sublessee accepts full responsibility for the consequences of Sublessee’s decision to operate a [franchise system] unit at the Premises in accordance with the terms of this Sublease, the Lease and the Franchise Agreement; and (i) Sublessee has thoroughly reviewed the Lease and this Sublease and has been advised by its legal counsel regarding the Lease and this Sublease, or Sublessee has made a reasoned and fully informed decision not to be so represented by counsel and understands and acknowledges the significance and consequences of such decision, and Sublessee is fully knowledgeable about and is fully satisfied with the terms and provisions, and assumes all of its obligations as tenant under, the Lease and this Sublease. Sublessee acknowledges that the foregoing representations by Sublessee are a material inducement to Sublessor’s execution of this Sublease.

15. Default.

15.1 An “Event of Default” will occur if at any time during the Term, (a) Sublessee defaults in the payment of Rent or any other payment due hereunder and the same is not cured within three days after written notice thereof; provided, however, Sublessor will be obligated to give only two (2) such notices in any calendar year, with subsequent payment default to be an Event of Default if such failure to pay continues for a period of three (3) days or more from the date such payment is due (without any notice), (b) Sublessee defaults in any other obligation under this Sublease, including, without limitation, causing or permitting the occurrence of any event that, but for the passage of time or the giving of notice, or both, would constitute a default under the Lease, and the same is not cured within ten (10) days after written notice thereof or such shorter cure period as may be set forth in the Lease, (c) Sublessee defaults in any obligation under the Franchise Agreement or any other agreement between Sublessor (or its affiliates) and Sublessee (or its affiliates), and the same is not cured within ten (10) days after written notice thereof, (d) any proceeding is begun by or against Sublessee to subject the assets of Sublessee to any bankruptcy or insolvency law or for an appointment of a receiver of Sublessee or for any of Sublessee’s assets or (e) Sublessee makes a general assignment of Sublessee’s assets for the benefit of its creditors.

15.2 Upon an Event of Default, Sublessor may at any time thereafter at its election, (a) terminate this Sublease, (b) terminate Sublessee’s right of possession in the Premises, (c) cure any such default and receive from Sublessee, as additional rent, all costs incurred in doing so, plus interest at the lesser of 15% per annum or the highest rate permitted by law; (d) exercise
any remedy available to Landlord under the Lease and/or (e) pursue any other remedies available at law or in equity. All Sublessor remedies provided herein will be cumulative and non-exclusive. Upon the termination of this Sublease or termination of Sublessee’s right of possession, it will be lawful for Sublessor, without formal demand or notice of any kind, to re-enter the Premises, by summary dispossess proceedings or otherwise, and to remove Sublessee and all persons and property therefrom. If Sublessor re-enters the Premises following an Event of Default, Sublessor will have the right to keep in place and use, or remove and store, all of the furniture, fixtures, equipment, signage, inventory and other items covered by Sublessor’s lien pursuant to Section 4.2 hereof. No action taken by Sublessor pursuant to this Section 15 will relieve Sublessee of its obligations under this Sublease or will be deemed an act terminating this Sublease or declaring the Term hereof ended unless notice is served upon Sublessee by Sublessor expressly setting forth therein that Sublessor elects to terminate this Sublease or declare the Term ended.

15.3 If, following an Event of Default, Sublessor terminates this Sublease, Sublessor may recover from Sublessee the sum of (a) all Rent and all other amounts accrued hereunder to the date of such termination; (b) the cost of reletting the whole or any part of the Premises, including, without limitation, brokerage fees and/or leasing commissions incurred by Sublessor and costs of removing and storing Sublessee’s or any other occupant’s property, and repairing, altering, remodeling or otherwise putting the Premises into condition acceptable to a new tenant or tenants and the Landlord; (c) all reasonable expenses incurred by Sublessor in pursuing its remedies, including, without limitation, reasonable attorneys’ fees and court costs and (d) an amount in cash equal to the then present value of the Rent and other amounts payable by Sublessee under this Sublease as would otherwise have been required to be paid by Sublessee to Sublessor during the period following the termination of this Sublease measured from the date of such termination to the expiration date stated in this Sublease. Such present value will be calculated at a discount rate equal to the 90-day U.S. Treasury bill rate at the date of such termination.

15.4 If, following an Event of Default, Sublessor terminates Sublessee’s right of possession (but not this Sublease), Sublessor may, but will be under no obligation to, relet the Premises for the account of Sublessee for such rent and upon such terms as are satisfactory to Sublessor without thereby releasing Sublessee from any liability hereunder and without demand or notice of any kind to Sublessee. If the Premises are not relet, then Sublessee must pay to Sublessor as damages a sum equal to the amount of the rental reserved in this Sublease for such period or periods, plus the cost of recovering possession of the Premises (including, without limitation, reasonable attorneys’ fees and costs of suit), the unpaid Rent and other amounts accrued hereunder at the time of repossession and the costs incurred in any attempt by Sublessor to relet the Premises. If the Premises are relet and a sufficient sum will not be realized from such reletting after first deducting therefrom, for retention by Sublessor, the unpaid Rent and other amounts accrued hereunder at the time of reletting, the cost of recovering possession (including, without limitation, reasonable attorneys’ fees and costs of suit), all of the costs and expense of repairs, changes, alterations and additions, the expense of such reletting (including, without limitation, brokerage fees and leasing commissions) and the cost of collection of the rent accruing therefrom] to satisfy the rent provided for in this Sublease to be paid, then Sublessee will immediately satisfy and pay any such deficiency. Any such payments due Sublessor will be made upon demand therefor from time to time and Sublessee agrees that Sublessor may file suit to recover any sums falling due from time to time. Notwithstanding any such reletting without termination, Sublessor may at any time thereafter elect in writing to terminate this Sublease for such previous breach.
16. **Brokerage.** Sublessee represents and warrants that, other than the “Broker” listed in Exhibit A attached hereto (the “Broker”), if any, it has dealt with no broker, agent or other person in connection with this transaction and that no broker, agent or other person brought about this transaction. Sublessee must pay to the Broker all commissions and other compensation due as a result of this leasing transaction and must indemnify, defend and hold Sublessor harmless for, from and against any claims by the Broker or any other broker, agent or other person claiming a commission or other form of compensation by virtue of having dealt with Sublessee with regard to this leasing transaction.

17. **Notices.** All communications or notices required or permitted to be given or served under this Sublease must be in writing and will be deemed to have been duly given or made if (a) delivered in person or by courier (including, without limitation, by Federal Express or other courier), (b) deposited in the United States mail, postage prepaid, for mailing by certified or registered mail, return receipt requested, or (c) faxed with confirmed transmission, followed by a hard copy in the mail on the next business day, and addressed as follows:

If to Sublessor:

If to Sublessee:

Facsimile: See Exhibit A

All communications and notices will be effective upon delivery in person or by courier to the address set forth in this Sublease, upon being deposited in the United States mail in the manner set forth above or upon being faxed in the manner set forth above. Any party may change his, her or its address or fax number by giving notice in writing, stating his, her or its new address, to the other party to this Sublease as provided in the foregoing manner.

18. **Personal Property Taxes.** Sublessee must comply with all legal requirements for filing a personal property tax return for, and paying all taxes assessed against, all personal property, equipment and fixtures located within the Premises during the Term hereof, such payment to be made by Sublessee directly to the taxing authority on or before the due date thereof.

19. **Quiet Enjoyment.** So long as Sublessee pays all amounts due hereunder and performs all other covenants and agreements herein set forth, and so long as no Event of Default exists, Sublessee must peaceably and quietly have, hold and enjoy the Premises for the term hereof without hindrance from Sublessor subject to the terms and provisions of this Sublease. As this is a Sublease, Sublessee agrees to take the Premises subject to the terms of the Lease and all matters of record.

20. **Governing Law.** This Sublease and all questions relating to its validity, interpretation, performance and enforcement will be governed by and construed, interpreted and enforced in
21. **Attorneys’ Fees.** If either party should prevail in any litigation or other legal proceeding instituted by or against the other related to this Sublease, the prevailing party, as determined by the court or the like, will receive from the non-prevailing party all costs and reasonable attorneys’ fees (payable at standard hourly rates) incurred in such litigation or other legal proceeding, including, without limitation, costs on appeal, as determined by the court or the like. Sublessee must also pay to Sublessor, as additional rent, Sublessor’s reasonable attorneys’ fees incurred as a result of any breach or default by Sublessee under this Sublease.

22. **Successors and Assigns.** Subject to Section 9, which restricts Sublessee’s rights to assign this Sublease and its rights hereunder, this Sublease will be binding upon and inure to the benefit of the parties and their respective assigns, legal representatives, executors, heirs and successors. Any attempt by Sublessee to assign this Sublease, or any of his rights hereunder, or to delegate his obligations hereunder, without compliance with the terms of Section 9 will be void. Notwithstanding anything contained in this Sublease to the contrary, Sublessor may assign this Sublease, or any of its rights hereunder, or delegate any of its obligations hereunder without the consent of Sublessee or any other person.

23. **Joint and Several Liability.** If Sublessee consists of more than one person or entity, the obligations hereunder will be joint and several.

24. **Entire Agreement.** This Sublease, including the exhibits hereto and the other agreements contained as exhibits to Franchisor’s Operating Manual, contains the entire understanding and agreement of the parties with respect to the subject matter hereof and supersedes, replaces and extinguishes all prior agreements and understandings between the parties with respect to that subject matter. Each of the exhibits and other agreements (whether between the current parties or a former sublessee) is incorporated in this Sublease by this reference and constitute a part of this Sublease. This Sublease supersedes all Subleases and Agreements of Intent to Sublet between the parties (or their respective affiliates) with respect to the Premises.

25. **Counterparts.** This Sublease may be executed in two or more counterparts, each of which will be considered one and the same agreement and will become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties.

26. **Time is of the Essence.** Time is of the essence as to the performance of the parties’ obligations under this Sublease.

27. **Waiver of Right to Jury Trial, Class Action and Certain Damages.** IN RESOLVING ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, BETWEEN SUBLESSOR AND SUBLESSEE ARISING OUT OF THIS SUBLEASE OR ANY OTHER INSTRUMENT, DOCUMENT OR AGREEMENT EXECUTED IN CONNECTION HEREWITH OR THE TRANSACTIONS RELATED HERETO, SUBLESSEE HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, (A) THE RIGHT TO A JURY TRIAL OR TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE, (B) THE RIGHT TO INITIATE OR PARTICIPATE IN A CLASS ACTION IN ANY FORUM, INCLUDING, WITHOUT LIMITATION, ARBITRATION, AND (C) THE RIGHT TO SEEK OR COLLECT PUNITIVE, CONSEQUENTIAL AND SPECIAL DAMAGES IN ANY FORUM, INCLUDING, WITHOUT LIMITATION, ARBITRATION.
IN WITNESS WHEREOF, the parties hereto have executed this Sublease, or caused this Sublease to be executed as of the Effective Date.
SUBLESSEE’S SIGNATURE PAGE

Date: ________________________________

SUBLESSEE: ________________________________

Check one:
□ Individual
□ Corporation
□ General Partnership
□ Limited Partnership
□ Limited Liability Company
□ Other Entity (Identify): ________________________________

State of organization or incorporation (if applicable):

______________________________

WITNESSES:

______________________________  EXECUTED BY: ________________________________
(Sign Name)  (Sign Name)

______________________________  (Print Name)
(Sign Name)

______________________________
(Please provide in the box)

IF EXECUTED ON BEHALF OF A CORPORATION, A PARTNERSHIP, A LIMITED LIABILITY COMPANY OR ANOTHER TYPE OF ENTITY, LIST TYPE OF ENTITY AND TITLE:

______________________________
(Print Name)

______________________________
(Sign Name)

______________________________
(Print Name)

[ADD NOTARY FOR STATE WHERE PROPERTY IS LOCATED]
SUBLESSOR’S SIGNATURE PAGE

Date: 
WITNESSES: [NAME OF FRANCHISOR]

__________________________________________
(Sign Name)
__________________________________________
(Print Name)

__________________________________________
(Sign Name)
__________________________________________
(Print Name)

STATE OF _____________ )
COUNTY OF _____________ )

On ________________, before me, ____________________________, personally appeared ________________, personally known to me (or proved to me on the basis of satisfactory evidence) to be the ________________ of [name of franchisor], on behalf of said [corporation/partnership, etc.].

WITNESS my hand and official seal.

(Seal) Notary Public
My commission expires: ___________
<table>
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<th><strong>Unit No. _______</strong></th>
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<td>Exhibit A to Sublease</td>
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<th><strong>Sublessee’s Facsimile #</strong></th>
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Unit No. ______

Exhibit B to Sublease

[attach copy of lease]
MARK D. SHAPIRO

Mark D. Shapiro is a partner in the Franchise & Distribution Group of Ballard Spahr Andrews & Ingersoll, LLP, and resident in the Voorhees, New Jersey office. Mark’s franchise practice includes counseling regional and national franchisors on franchise structuring as well as operational, relationship and regulatory issues. He is also a member of the Real Estate Department and represents developers, franchisors, entrepreneurs and non-profits in the acquisition, lease and development of real property and real estate taxation. Mr. Shapiro has participated as a program presenter on franchise law for the ABA Forum on Franchising, the International Franchise Association, New Jersey Institute of Continuing Legal Education, and the Pennsylvania Bar Institute and on real estate law for Lorman Education Services. He served as a Secretary of the New Jersey State Bar Association’s Franchise Law Committee from 1997 to 1999 and has been a member of the American Bar Association’s Forum Committee on Franchise Law since 1996. From 1997 through December 2000, he served as Special Tax Counsel to Voorhees Township, New Jersey.

Mr. Shapiro has been twice selected as a “40 Under 40” New Jersey Lawyer by the New Jersey Law Journal. He has been honored by New Jersey Monthly Magazine as a “New Jersey Rising Star Super Lawyer” in the area of Real Estate.

Mark is a 1990 graduate of Emory University and a 1993 graduate of George Washington University National Law Center. He is admitted to the Bars of the State of New Jersey and the Commonwealth of Pennsylvania.
SUSAN E. WELLS

Susan E. Wells has been the President of Susan E. Wells, P.C., located in Phoenix, Arizona, since August 1993. Before establishing her own law firm, she practiced with both national and local law firms as a corporate transactional attorney, specializing in securities law, mergers and acquisitions and health care law. Susan’s current practice ranges from mergers and acquisitions to corporate formations, with a specialty in counseling national and regional franchisors with respect to franchise structuring, contractual, operational, relationship and regulatory issues. She is a member of the American Bar Association Forum on Franchising, the State Bar of Arizona and the Arizona Franchisor Association. In addition, she served as Vice President of the now-defunct Arizona Licensor and Franchisor Association. She is admitted to practice in the States of Arizona, New York and New Jersey. She is a 1980 graduate of Brooklyn Law School and a 1976 graduate of The University of Wisconsin-Madison. She is listed in Phoenix Magazine as one of Phoenix’s Best Attorneys and is listed in The Best Lawyers of America.