The Intersection of Franchise and Real Estate Law

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Cast of Characters:

Franchisee = Red Goodman
Franchisor = Jimmy
Landlord = Lainey LaFleur
Tenant, Guarantor and Security Deposit

Who is tenant?

Who is guarantor?

- What is guaranteed? Monetary vs. Non-Monetary.
- Is there a $ limit?
- How long does it last?

Security Deposit

- How much?
- Can all or a portion be released prior to lease end?
Cap on CAM charges, Exclusions and Audit Rights

In addition to base rent, Tenants usually reimburse Landlords for a share of real estate taxes, common area costs and insurance for the center.

• What is included and excluded in CAM?
• How is it billed to Tenants? Fixed charge vs. prorata actual.
• Will the Tenant be entitled to audit rights?
Co-Tenancy

- Tenant is permitted to pay reduced rent unless certain occupants or a specified % of the center is open for business.

- Poor performing centers impact business and a reduction in rent reduces the pain of lost revenue.
Waiver of Landlord Lien

• Lenders often provide financing secured by tenant’s inventory and FFE

• Lender needs comfort that it can execute on its collateral without Landlord’s interference
Renewal Rights

The lease term must match the time periods under the Franchise Agreement, including renewal periods.

If there is an obligation to operate under the FA, there must be a space to do that.

• What are renewal conditions?

• What will the rental rate be during the renewal periods?
• Franchisor’s Main Points

1. Notice of Default and Right to Cure
2. Assignment of Lease
3. Use Provision
4. Exclusivity
5. Access to Space
6. No Assignment/No Amendment
7. Radius Restriction
Notice and Right to Cure

• Franchisor to receive copies of Tenant notices

• Franchisor has the opportunity to cure the default

• Franchisor’s election to cure does not mean it assumes the Lease
Lease Assignment

- Tenant assigns its rights under the Lease to Franchisor, its affiliate or designee, subject to the following conditions:
  - Tenant fails to cure or renew
  - Assignee (franchisor, affiliate or designee) cures and elects to assume in writing
Use Clause

• The leased premises may only be used for the operation of a Gymmie’s Fitness franchise

• The leased premises may only be used as a fitness facility
Exclusive Use

• Clause which limits the rights of other tenants to offer competitive goods or services within the center
  
  o E.g. Tenant shall be the only Italian restaurant or health club (business specific)

  o Tenant shall have the exclusive right to sell “pizza” or offer group fitness classes (product specific)
Access to Protect the System

• Franchisor shall have the right to inspect and cause de-image

• Franchisor agrees to repair any damage caused by such entry and indemnify Landlord

• Tenant shall reimburse Franchisor for the costs of such de-identification
No Amendment

• No renewal or extension of term without Franchisor’s consent

• No lease amendment or modification without Franchisor’s consent

No Assignment or Subletting

• Tenant may not assign its interest in the Lease, nor sublet the Premises, without Franchisor’s consent
Radius Restriction

A covenant that Tenant will not operate a competitive business within a certain distance (eg. 3 miles) from the leased premises

• Tenant needs to focus on this site succeeding

• Does the restriction apply to Franchisor or other franchisees?
Gymmie’s Is Ready to Open!
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Exclusivity Provisions in Leases

• Be mindful of how businesses change and offerings grow.
  • Gyms $\rightarrow$ Pilates, Juice Bars
  • Fruit bouquets $\rightarrow$ smoothies
  • Smoothie shops $\rightarrow$ sandwich sales
• Example: Definition of “gym” or “sandwich”
Fast forward.

We are now 14 years into the 15 year franchise term.
30 days later...
Note to Franchisees: Never withhold rent! (Almost)

- Unless your lease provides you with the right to offset rent (which is rarely the case), the obligation to pay rent is independent of the landlord’s obligation to make repairs.
- At common law, the obligation to pay rent ran with the land, and was independent of contractual obligations.
Note to Franchisors: Careful how you word your default triggers!

• Trigger default upon receipt of the landlord’s termination notice or filing of an eviction action.
• A default triggered by a disputable event could require the franchisor to wait on the adjudication, creating protracted uncertainty.
• A default triggered by franchisee losing possession of the premises, would require an actual eviction.
Limited Licenses

Good tool to use post-termination to avoid litigation and maintain the location (especially in bankruptcy). Key terms:

- Limited continued operation pending sale.
- Release of claims against franchisor re: improper termination, etc.
- Franchisee deposits liquidated damages in escrow.
Limited Licenses – limited by lease.

- If tenant is in default of the lease, an assignment may be prohibited.
- If the franchise agreement has already been terminated, there may be a short fuse under the lease rider to do the assignment.
- May be able to overcome some of these obstacles by working with the landlord, particularly if the landlord wants to maintain the concept as a tenant.
Landlord’s Consent to Assignment


- Consent withheld: 10 months remaining on term.  Wanted to do direct deal.
- The trial court held, and Tennessee Court of Appeals agreed that simply wanting a better deal is not a reasonable basis for withhold consent, and the landlord breached the lease by not consenting to the assignment, even with only 10 months left on the initial term.
Lease Options Enforced


- Franchisee owned the real estate.
- Franchisor had an option requiring the franchisee to lease the space to the franchisor at the franchisor’s election upon termination.
- Court ruled in favor of franchisor’s claim for specific performance: Dunkin’ Donuts showed that “an inability to preserve the goodwill already accumulated at the location would result in irreparable harm to [it].”
Can a landlord be compelled to de-identify?

Contributory Infringement: Is the landlord facilitating an infringement in commerce?

- See *Polo Ralph Lauren Corp. v. Chinatown Gift Shop*, 855 F. Supp. 648 (S.D.N.Y. 1994) (trademark holder prevailed on landlord’s motion to dismiss contributory infringement claim where landlord knew infringer was selling counterfeit goods on the premises).

- But see *Coach, Inc. v. Swap Shop, Inc.*, 916 F. Supp. 2d 1271 (property ownership alone is insufficient to establish contributory infringement).
Injunctive Relief: Irreparable Harm v. Money Damages


• “[Franchisee] may pursue her damage claims against BKC, including her wrongful termination claim, but she may not continue to use the BKC Marks in the operation of her restaurant.” *Burger King Corp. v. Hall*, 770 F.Supp. 633, 638-9 (S.D. Fla. 1991).

Fixture: Landlord’s favor

• A fixture is “personal property that is attached to land or a building and that is regarded as an irremovable part of the real property, such as a fireplace built into a home.” *Black’s Law Dictionary* (10th ed. 2014).

• Under §9-102 of the UCC, fixtures are “goods that have become so related to particular real property that an interest in them arises under real property law.”
Trade Fixture: Tenant’s favor

A trade fixture “is (1) annexed to the property for the purpose of aiding in the conduct of a trade or business exercised on the premises; and (2) capable of removal from the premises without material injury thereto.” Handler v. Horns, 2 N.J. 18, 24-25 (1949).
Subordination agreements, intercreditor agreements, etc. will need to provide for the removal of the franchisor’s trademarks prior to exercising any lien rights.

If there are no such agreements or if those agreements are ignored, the franchisor will need to seek injunctive relief to have the marks removed prior to transfer or liquidation.

Since the equipment would be sold with the marks, the “in commerce” requirement under the Lanham Act would be triggered, making injunctive relief likely successful.
Membership lists

- Landlord’s interest
- Franchisee’s interest
- Franchisor’s interest