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FRANCHISEE TENANT CHECKLIST:

LOOK BEFORE YOU LEAP INTO A LEASE


Terrence M. Dunn

In the course of opening a location for your franchised business you will likely be entering into a leasing arrangement, either in the form of a sublease from the franchisor or a direct lease with a landlord.

Leasing space for a business operation is complicated enough under any circumstances, but particularly so in the franchising context, because the landlord and the franchisor each have a set of concerns that they will want to apply to the lease negotiations.

As a prudent businessperson, you will examine the location primarily from the point of view of how well it will serve as a business location for your particular franchised business. That examination will focus on traffic, parking, surrounding businesses, quality of the structure and location. The lease will seem like an unfortunate but necessary formality. In a best case scenario your lease will never have to be taken out of the drawer. However, a good lawyer would counsel you to analyze the situation from a worst case scenario as well; that is, what will happen if things do not go well? In that case the terms of the lease become vital, frequently becoming the difference between survival and failure. Here are some of the areas that can impact on that determination and some of the questions you should ask when reviewing your lease:

- Liability: Will you be asked to personally guaranty the obligations of your corporate or LLC tenant, and if so will that guaranty be unlimited or a "good guy" guaranty? You must distinguish between your company's liability under the lease and your own personal liability. If a guaranty is required, a "good guy" guaranty is much more preferable, in which you only personally guaranty the rent while you remain in the space.
- Landlord's work (if any), and tenant's work: The lease should clearly define what will be done to build out your space and who is going to do it. There must be a statement of who performs the construction and who can control that performance, as well as who pays for the construction and how it will be paid for (construction allowances, work letters, rent credits, etc.) If you are relying on the landlord to build your space, your lease must have controls built into it so that you can make certain the work is done properly and so that you have recourse if the work is unacceptable.
- "As is" delivery: Many landlords will want you to waive claims for the existing condition of the property; if so, you should examine the space carefully with an engineer.
- Sublet/assignment rights: What is permitted and prohibited? This clause could provide a potential backdoor out of an unsuccessful location. At a minimum you want your landlord to be reasonable in considering your request. You may also be able to negotiate a pre-approved set of criteria for an acceptable assignee or sublessee. If you decide to sell your business, you must have the right to assign the lease and be careful the landlord does not try to get a share of your sale price.

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- Operating covenants, change of use and going dark: Can you cease operations or change your use if it makes no economic sense to continue with the franchised business?
- Casualty, insurance and related termination rights: What extraordinary events will permit you to terminate your lease? How quickly will the building and your space be restored in the event of fire or other damage? What is the relative responsibility of the tenant and landlord to restore the building and its interior? How long can this process take? These clauses are being scrutinized because of Hurricane Sandy. There should also be a clause defining insurance coverage and who bears that expense.
- Repairs, alterations and compliance with laws: Who will be responsible for maintaining the building and your space and at whose cost? Your landlord should maintain the building and all structural elements of your space, as well as crucial infrastructure such as plumbing, electric and utility lines. You will be asked to maintain your premises. Be careful here and elsewhere of a landlord trying to shift its obligations to you.
- Operating and maintenance expenses: How much of the Landlord's overhead are you supporting? Inclusions and exclusions should be scrutinized so that you are not paying for administrative expenses or capital improvements.
- Percentage Rent, escalations and other forms of additional rent: How much is this space really going to cost you? Base rent only tells part of that story. You must analyze each aspect of the lease that could result in a charge to you and be certain you have specific numbers for those charges.
- Real estate taxes: How much of the property's taxes are being passed through to you as tenant? Have you investigated how much those taxes might increase in the future? If you are responsible for tax escalations (as opposed to a share of all the taxes), you must determine what the "base year" is and obtain a historical sense of how much taxes have increased in the past. You must also be sure the percentage allocated to you is equitable in relation to the rest of the building.
- Competition: Depending upon the location, it may be worth inquiring into whether or not your landlord can give you protection against competitive businesses; such as agreeing not to lease to a similar business in the building, mall, center or an extended geographical area.
- Franchisor's rider: Most franchisors will provide you with guidelines or actual language they require to be included in the lease. These provisions deal with assignment rights and other provisions that will enable the franchisor to protect the location if you fail or default. You must examine these provisions carefully to be certain they do not cause you to compromise any of your rights. You must convince your landlord to include this in the lease in order for your franchisor to approve the lease.
- Verbal promises: You must disregard what the broker and the landlord told you during your discussions. Those representations and promises carry no weight once the lease is signed. Read the lease and discuss it with a competent real estate attorney. A careful lease analysis and thorough negotiation can significantly reduce your financial liability and spare you considerable logistical headaches down the road.

Terrence M. Dunn is one of the founding partners of Einbinder & Dunn, LLP, a business law firm located in Midtown Manhattan. The founding partners of the firm have been together for over 20 years and the firm is well known in its areas of expertise, including business, franchising and litigation. Mr. Dunn has written and spoken frequently on various aspects of real estate and franchising law, including for the the American Bar Association Forum on Franchising.

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