

# Understanding Franchise Leases: What Franchisors, Franchisees, and Landlords Need to Know

By Eric Sigman on March 25, 2025



For a franchisee, entering into a franchise agreement with a franchisor is just the first step in their new journey to entrepreneurship. Following the execution of the franchise agreement, the franchisee will simultaneously go through the franchisor-required training while also making one of the most important decisions in the process—selecting the location of their business. This location is crucial to the franchise's success, and once the location is selected, the franchisee must also negotiate a retail lease with the landlord.

## Franchisors and Real Estate Control

Franchisors have an interest in controlling the real estate of their franchisees for a variety of reasons. Some franchise systems own or lease the property themselves, then lease or sublease it to franchisees. Most franchise systems, however, put the burden and risk of the lease obligations on franchisees by requiring that a franchisee either purchase or lease the real estate for their business. In the case of a lease, the franchisor often seeks to have some key provisions inserted into the lease or, in most cases, requires a separate addendum or rider to be included in the lease, which grants the franchisor certain rights in the franchisee's real estate.

## The Retail Lease and Franchise Addendum

Generally, a retail lease is both a grant of an interest in real estate and a contract that forms the basis of the use by the tenant of that real estate by defining the rights and obligations of the tenant and the landlord.

However, when it comes to franchised businesses, there's an additional party involved—the franchisor. Most franchise agreements require the franchisee to seek the franchisor's approval on both the location of their franchised business and the lease for that real estate.

The franchisor will generally have a lease addendum or rider that incorporates certain provisions that protect the franchisor's rights in the franchised business and, as a result, the premises from which that business operates. While the interests of the franchisee and franchisor in a retail lease are frequently aligned, the specific interests of the franchisor in the franchisee's real estate can pose unique challenges for the landlord and, as a result, pose certain challenges for the franchisee in negotiating the lease.

The franchisor lease rider or addendum defines the relationship between the franchisor, franchisee, and landlord with respect to the premises, and franchisors, franchisees, and landlords often are forced to negotiate the issues raised in the franchisor addendum or rider in addition to the provisions of the lease. The franchisor will not approve a location or

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a lease without including their addendum, which can materially alter the lease terms, often to the benefit of the franchisor and tenant/franchisee and the detriment of the landlord. As a result, Franchisees can find themselves stuck between the franchisor and the landlord when it comes to issues such as the franchisor's right to step into the franchisee's shoes upon a default, the franchisee's right to assign the lease, and the franchisor's right to cure certain franchisee lease defaults.

While many complicated issues arise in retail leases, below is a discussion of three of the most frequently negotiated issues in retail leases for franchised locations.

## 1. Assignment

One of the most controversial parts of any lease can be the ability of the tenant to transfer or assign the lease to another tenant.

A tenant/franchisee (and, in turn, the franchisor) will want to retain some flexibility in its ability to assign the lease in the future, whether they are facing a default or business closure or as part of its exit strategy. If a franchisee plans to acquire a unit or units of a franchise brand, build it up, and then sell it, the ability to transfer the lease with as little restriction as possible is paramount.

On the other hand, the landlord often underwrites a lease with the original tenant in mind and will inevitably want to ensure that any new tenant is financially stable and reliable. Most landlords rightfully want the ability to approve any assignment or transfer of the lease to control issues like tenant mix, brand competition, exclusivity grants, and the creditworthiness of their tenants. Many times, tenants will negotiate either certain permitted transfers or criteria for the landlord's consent. For example, a tenant may request that the landlord's consent to an assignment not be unreasonably withheld, conditioned, or delayed, whereas a landlord may want the right to approve the assignment in its sole discretion.

This issue becomes even more complex when a franchisor is involved as a franchisor has a stake in the location's success. One of the fundamental building blocks of a franchise is a strong brand. Brands can be adversely affected by many factors, including a franchisee's failure in a particular location. The franchisor addendum typically contains provisions that allow the franchisee to assign the lease to the franchisor without the landlord's consent so that the franchisor can step into a failing location and preserve the brand's integrity.

Additionally, franchisor addendums usually go even further – they often include provisions that allow the franchisor to assign the lease to another qualified franchisee without the landlord's consent. This provision can be a difficult pill for the landlord to swallow as it erodes its right to consent to an assignment of the lease. If a landlord does agree to this language, it will generally carry with it an obligation of the party assuming the lease to cure any defaults before taking possession.

## 2. Cure Rights/Step-in Rights

Retail leases mostly outline the various ways a tenant can default on the lease, including non-payment of rent and certain non-monetary defaults. In many cases, these defaults afford the tenant the right to notice and an opportunity to cure. For a franchisor interested in maintaining the continuity of a brand at a specific location, having notice of a tenant default is essential. The franchisor lease addendum or rider will often amend the lease to require the landlord to notify the franchisor of any tenant defaults contemporaneously. In addition, in most franchisor lease riders, the franchisor will also request cure rights, affording the franchisor the right to cure a default on behalf of the tenant/franchisee.

Curing the default allows the landlord to ensure continuity at the premises by avoiding having the landlord terminate the lease. This right, coupled with the right to either assume the lease or transfer the lease to another tenant, allows the franchisor (and a replacement franchisee) to capitalize on the goodwill of the brand related to that specific location.

Landlords may resist this language because it could potentially complicate or prolong the cure period and, therefore, the lease termination process. On the other hand, a franchisor taking over a location may not be the worst result for a landlord as it avoids the location going dark and ensures, or at least gives the promise of, continuous operations in the face of a tenant default.

### 3. Radius Restrictions

Franchisors and landlords are generally aligned in their interest to see the franchisee/tenant focused on maximizing their efforts on operating the franchised business at the premises. For franchisors, it is important that the franchisee maximize sales at a particular location, as greater sales mean greater royalty fees and an enhancement of the brand in a particular market. For landlords, a healthy tenant means not only reliable rent payments (and for leases with percentage rent, maximized sales) but also the overall success of the center.

A radius restriction is a limitation on the ability of a tenant to operate a similar business within a certain area or radius of the premises. The idea is that if the tenant opens a similar business within close proximity of the premises, it will divert sales to another location. The distance of the radius is a negotiation between the tenant and the landlord and usually depends on factors like population density and the nature of the business.

A landlord will want the radius restriction to be as broad as possible to capture, among other things, the tenant's attempt to circumvent the provision through affiliated entities. However, the franchisor (and, by extension, the tenant/franchisee) will want the language to be as narrow as possible to avoid these provisions from capturing other locations owned by franchisees or, more importantly for the franchisor, locations owned by the franchisor in the event of an assignment of a lease to the franchisor, the exercise of its step-in rights, or otherwise. As a result, most franchisor lease riders or addendums will seek to eliminate these clauses from a lease.

#### The Bottom Line

A franchise structure involves multiple parties with competing interests, especially in physical or brick-and-mortar locations, which can result in complex legal documents and sometimes difficult negotiations. This article discussed only a few issues facing landlords, franchisors, and franchisees as they enter into these arrangements, and each party needs to understand their role and rights within the lease to ensure a successful, long-term relationship. Clear communication and thoughtful negotiations can help smooth the process and prevent potential issues down the road.

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