Restaurant Lease Agreements

A Practical Guidance® Practice Note by Michael B. Kent, Kent, Beatty & Gordon, LLP

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This practice note discusses key considerations when negotiating a restaurant lease including (1) initial steps, (2) the term sheet, (3) due diligence and lease contingencies, (4) key lease provisions, and (5) special considerations for restaurants located in mixed-use projects, shopping centers, and hotels. This note also briefly addresses certain COVID-19 pandemic lease considerations. This practice note is written from the tenant's perspective, but discusses issues that are vital to the landlord and its counsel as well. Counsel to both parties should consult local counsel if they are not familiar with relevant local laws, regulations, customs and practices relating to the leasing process. These can vary greatly, sometimes with major substantive consequences.

This note focuses on leasing issues that arise due to the unique nature of restaurants and though it addresses some general retail leasing concerns that play a significant role in restaurant leasing, it does not discuss all general retail leasing concerns. For more on drafting retail leases generally see Retail Lease Agreements and Attorney's Role in the Retail Leasing Process.

For a sample restaurant lease form see Restaurant Lease in Small Shopping Center (Short Term) (Short Form) (FL). For an annotated form of retail lease that can be adapted for a restaurant space see Retail Lease Agreement (Long Form).

Initial Steps

To properly represent a potential restaurant tenant, counsel must first understand the client's needs. For example, is the client an experienced restaurant operator, perhaps even a national chain? Or is your client opening its first venture and thus relatively unsophisticated in the daunting realities of opening and successfully maintaining a new restaurant?

At the outset, counsel should determine who will quarterback tenant's lease efforts as these often involve more than negotiating, drafting, and revising a document. In addition to negotiating and drafting the lease, will your client also rely upon you to navigate the regulatory landmines of the local building department, health department, and alcohol beverage control (ABC) board? Depending upon how early in the process you are retained, the experience of the client, and the client's budget for legal services, you may be asked to assist the client with assembling the proper support team, starting with a broker who specializes in restaurant leases, followed by restaurant-experienced architects and engineers, and even a liquor license attorney (if a liquor license is to be obtained).

If, at the other extreme, your client is a sophisticated operator of a restaurant chain, your client may have its own in-house legal department, and only need you to act as local counsel to bring your knowledge of local practice and, with a local architect and engineer, to deal with the building codes. Be certain to understand the client's expectations of your role, especially when you are dealing with a client with a limited budget for legal fees.

The Term Sheet

A non-binding term sheet (or letter of intent) is typically the first step in the process and can be viewed in two distinct lights: either as a blueprint (some would say a bible) for the deal or a mere invitation to negotiate. It is in the tenant's best interest to treat the term sheet as the actual framework for the deal. To not do so may be perceived as a sign of bad faith and create a lack of trust when the actual lease negotiations begin. Although the parties' brokers generally spearhead this phase, a prospective tenant is best served by involving its counsel at this early stage.

A term sheet will spell out the basic business terms of a proposed lease (e.g., term, base rent, escalations, rent concessions, security deposit, personal guaranty, responsibilities for tenant's buildout, utilities, repairs obligations, and basic assignment and sublet rights), leaving many of the key so-called legal aspects to be fleshed out by counsel during the lease drafting stage. Because many issues will surface when converting what may be as short as a three-page bullet-point term sheet into a 60 page or more lease, it is in both parties' best interests to craft as detailed a term sheet as possible. For general forms see Letter of Intent (Retail Lease) (Long Form) and the less preferable Letter of Intent (Retail Lease) (Short Form).

Counsel also must also take the location of the restaurant into consideration. Will it be in a free-standing building, in a mixed-use project (with offices and/or residential apartments above), a shopping center, a hotel, or a casino? Each of the foregoing presents the practitioner with its own set of wrinkles and complications, many of which are explored below.

Note that in a mixed-use project, the lease is not the only document that governs the operation of a restaurant. There often is an agreement among the owners of the project's components called a Declaration of Covenants, Conditions and Restrictions which will be incorporated by reference into the lease, thus binding your client. Counsel should be aware of any provisions in the declaration that could materially impact the client's tenancy to determine whether these provisions need to be addressed in the term sheet.

In addition, the physical condition of the space upon delivery of possession should be considered. Will the landlord be required to deliver only a so-called "vanilla shell" with the tenant having to do a full build-out? Or will the new tenant be presented with an almost turn-key operation through a "key money" deal, where an existing restaurant lease is assigned to a new tenant, with all furniture, fixtures & equipment (FF&E) included (and, in some jurisdictions, perhaps a transferable liquor license) for a key or fixture fee?

If the tenant is a franchisee-operator, its franchisor likely will require that the lease contain an acknowledgment by the landlord of certain of the franchisor's rights under the franchise agreement, should the franchisee default under the lease. This, too, should be spelled out in the term sheet and not left for the lease negotiations.

Due Diligence and Lease Contingencies

Due diligence efforts are critical to the leasing process but can be time-consuming and expensive. Timing is a major issue. Basic due diligence efforts can be commenced even before the term sheet is agreed upon; however, it is often not until the term sheet is in place that these efforts will begin in earnest. Once the term sheet is in place, thus assuring the client of a good faith basis for proceeding, the client is faced with the following quandary: should due diligence efforts be commenced ahead of drafting the lease only to face the possibility that the lease will not be consummated, thus costing the client substantial time and money, or should the due diligence efforts be deferred until the lease is in place? The caveat here is that by deferring the due diligence, the client may fail to uncover, until it is too late, that there are circumstances extant (e.g., zoning restrictions, inadequate building systems) that might result in the tenant leasing a space it cannot fully utilize.

The term sheet should not be negotiated in a vacuum. Counsel to a potential restaurant tenant should urge its client to allow certain due diligence efforts to be performed at this early stage (especially by accessing readily available public records) to establish the base suitability of the property for the operation of a restaurant. You should consider making an initial site visit with your client and its architect. Certain substantive issues may be discovered at a site visit which should be addressed as early as possible and included in the term sheet. However, there are certain types of contingencies which cannot be resolved through due diligence efforts (i.e., those for which the outcome can only be known with the passage of time, such as obtaining building permits, zoning variances, and liquor licenses). These cannot be left to chance, and the tenant must be protected against a possible negative outcome by including appropriate termination contingency clauses in the lease

For example, the ability to obtain a liquor license is critical as most restaurants cannot survive without the revenues from such sales. Although the outcome of an application

to the ABC board generally will not be known until several weeks after the lease is executed and the application submitted, in certain jurisdictions a liquor license may not be available as a matter of law due to the location of the proposed restaurant (for example, if the location is near a place of worship or a school). These threshold disqualifying factors are easy to identify and should be resolved during the term sheet stage, leaving the actual issuance of the license as a lease contingency.

For sample contingency clauses see Liquor License Contingency Clause (Restaurant Lease) and Adequacy of Utilities Contingency Clause (Restaurant Lease) (Pro-Tenant). In each of these clauses, if the contingency is not satisfied, the tenant is able to terminate the lease without liability or further obligation. Note, however, that landlords frequently require the payment of a liquidated amount for a tenant's exercise of the right to terminate, or reimbursement for the landlord's (non-contingent) brokerage fees, legal fees and money expended readying the premises for the tenant. Bear in mind that even if the tenant can walk away without paying anything to the landlord, the tenant will lose its out-of-pocket investment to that date, including initial build-out costs, professional fees and, possibly, rent payments.

COVID-19 Pandemic Considerations

After the 2020 onset of the COVID-19 pandemic, real estate attorneys were inundated with pleas from their restaurant clients desperately seeking to have their leases renegotiated to allow for some combination of partial abatements, temporary rent reductions, and rent carry forward deferrals. Many practitioners first turned to the contractual defense of force majeure. The force majeure clause, although hardly unique to restaurant leases, usually was afforded scant attention during lease negotiations, as it was often viewed as a boilerplate-type provision. The pandemic caused these clauses to be placed under a microscope whereupon it was discovered that the standard force majeure clause offered little, if any, solace to a tenant. Even if a pandemic was within the clause's definition of a force majeure event, whether expressly stated (often not), or deemed to fall within the "other unforeseeable event" criteria, virtually all force majeure clauses provide that the occurrence of the specified force majeure event will not excuse the payment of rent. At best, it only excuses temporary performance of a tenant's non-monetary obligation during the period in which the force majeure event continues.

Nonetheless, in some situations, landlords, taking into account both the landlord's and tenant's financial and other circumstances, would make limited concessions. (Note that in negotiating a lease modification, the practitioner also should ensure that such savings cannot be recaptured under a related personal guarantee.) However, where negotiations proved unsuccessful, litigation often ensued. Although there is a developing body of COVID-19 case law, with variations in outcome throughout the country, in most instances a tenant's effort to avoid paying rent were unsuccessful as the oft-advanced common law defenses of frustration of purpose and impossibility of performance were rejected by the courts.

Alternatively, many tenants who were unable to achieve satisfactory lease modifications were compelled to seek the protection of their existing business interruption insurance policies (intended to provide significant protection in the event a covered peril forces a business to cease operations for a specified period time). Unfortunately, with the exception of a few outlier cases, courts uniformly have rejected these coverage claims either on the basis that a pandemic was an express policy exclusion (which became a more frequent practice after the SARS outbreak in 2002), or as a matter of law inasmuch as the required condition of there being "direct physical loss of damage" to the insured's property was not satisfied.

As such, at least prospectively, a practitioner, after reviewing the developing case law and commentaries on this subject, should devote attention to crafting a more tenant-favorable force majeure clause. At a minimum, the clause should expressly provide that a pandemic is a force majeure event. Language such as "should any actual or threatened health emergency, epidemic, pandemic (including, without limitation, COVID-19), governmental shut-down, or restriction on essential or nonessential business, or government preemption or restrictions or by reason of any rule, order or regulation of any department or subdivision thereof of any government agency or by reason of the conditions which have been or are affected, either directly or indirectly, thereby…" should be considered.

In addition, an aggressive practitioner might try to obtain some form of conditional rent payment protection for the restauranteur by adding language to the effect of the following:

> … provided that in no event shall the foregoing [the pandemic force majeure event] excuse Tenant from its obligations to pay base rent and additional rent as and when due and owing under this Lease unless Tenant is required to completely close for business to the public with respect to eat-in dining for a period of up to one-hundred eighty (180) days due to a federal, state and/or local executive order resulting from a pandemic or

other health crisis. In the event Tenant is required to completely close for business to the public due to such governmental action, Tenant's base rent shall be abated for a period of up to one-hundred eighty (180) days but Tenant shall continue to be obligated to pay additional rent and all other charges as due and owing under the Lease during such abatement period.

Not surprisingly, except in those situations where the tenant has superior negotiating leverage, it will be all but impossible to obtain this protection for the client.

Key Lease Provisions – Use

While the use provisions discussed below are not entirely unique to restaurant leases, all are very important to a restaurant operator.

Permitted Use

The permitted-use clause determines the allowable scope of a tenant's use of the premises, often by describing, in varying degrees of specificity, the actual concept and style of the restaurant. At its most basic, a permitted use clause would read similarly to the following:

> Tenant shall use the Demised Premises solely for the purpose of conducting the business of a restaurant for on premises consumption and the sale of beer and alcoholic beverages, provided that Tenant shall have obtained all appropriate licenses and permits.

It is more likely, however, that the landlord will seek to limit the permitted type of cuisine and décor of the restaurant, in more extreme cases requiring a menu to be attached as an exhibit to the lease as a limitation of what the tenant may offer. If faced with this, a tenant should agree only to generally serve the types of items shown on the menu but retain the right to alter the menu consistent with the described style and concept of the restaurant. (For a more detailed use clause with some operating provisions, see Permitted Use Clause (Restaurant Lease, Office or Retail Space) (Pro-Landlord).) However, unless the lease includes a percentage rent obligation (see discussion below), the operator of a freestanding restaurant should be subject to few, if any, restrictions on the use of the premises for the operation of a restaurant (other than, perhaps, the basic concept and style).

In some situations, the permitted use will include the utilization of an outdoor patio area. The lease should specify whether any additional rent will be incurred for the use of the patio. In some urban areas, the outdoor area may be on a public street which would also require a permit from the municipality. You can expect to be faced with strict noise and hours of operation restrictions. See Outdoor Patio Clause (Restaurant Lease).

Exclusive Use Rights

Most shopping center (and some mixed-use) restaurants enjoy exclusive use rights while also being subject to the exclusive use rights that were granted to other tenants. In return for this protection, the operator of a restaurant with a circumscribed cuisine may be prohibited from selling food items exclusively reserved to other restaurants. For example, the lease may state something like:

> Tenant shall use the Demised Premises solely for the purpose of operating a full service first-class Malaysian restaurant (or Asian restaurant of similar quality and décor), and for no other use or purpose. However, under no circumstances will a Chinese fast food, Chinese kitchen, basic Chinese restaurant or Japanese restaurant be deemed to constitute an "Asian Restaurant" or "Permitted Use" for the purpose of this Section.

Tenant should ask for exclusivity for tenant's style of restaurant that is as broad as possible, and carefully review all exclusive use rights granted to other tenants to confirm that they will not adversely impact tenant's operation. Sound practice dictates that you obtain and attach the verbatim exclusivity language from the other tenants' leases as summaries may be inaccurate.

Operational Provisions

Required Hours of Operation

Many landlords like to dictate the hours and days of operations. There is justification for a reasonable operating schedule if the restaurant is in a shopping center, mixed-use project or where the lease includes a percentage rent provision. Otherwise, the landlord should have minimal input on this subject. Many landlords also seek to require the restaurant to be open year-round. Tenant's lawyer should negotiate for certain permitted "dark" periods to allow for renovations, observance of certain holidays and force majeure events. For a sample clause, see Operating Clause (Restaurant Lease, Shopping Center) (Pro-Landlord).

Noise and Odors

Noise and cooking odors are a natural part of the restaurant experience; however, they can also be the source of unpleasant conflicts with other residents and workers in a mixed-use project. A basic lease prohibition would provide that "Tenant shall not suffer, allow or permit any offensive or obnoxious vibration, noise, odor or other undesirable

effect to emanate from the Premises." Regardless of the specificity of the language, you should make sure that the lease does not allow the landlord to implement any default measures until the tenant is provided with a detailed notice of the alleged offense and has a reasonable time to remedy the problem. A clause favorable to tenant with respect to odors in a mixed-use project is:

> Notwithstanding the foregoing, Landlord understands that some odors are necessarily associated with the operation of a restaurant and that subject to the following conditions, the presence of such odors in the exterior of the Premises shall not constitute a breach of this Lease. In the event such odors (or smoke) are present in the residential apartments or in the Common Areas resulting in a continuous problem to residents, upon Tenant's receipt of supporting evidence that such odors are caused by Tenant's operations, Tenant, within twenty (20) days thereafter, shall use commercially reasonable efforts to remedy the situation at its sole cost and expense. "Commercially reasonable efforts," for purposes of the foregoing, may include the installation of apparatus similar to a so-called "air ionizer," "portable collector," "fume extractor," "coolant mist collectors," "scrubbers" or other electro-static exhaust systems in combination with passive filtration methods, reasonably acceptable to Landlord.

With respect to noise issues, inside noise often can be contained, at least to a reasonable degree, by adequate sound insulation. The type and rating of the insulation, and responsibility for its cost, should be specified in the lease. Note that some leases will specify an acceptable range of outside volume levels (by decibels) for sounds escaping the restaurant, whether based on local ordinance or otherwise.

Other obligations a restaurant operator is likely to be charged with include installing and maintaining in all cooking areas approved chemical fire extinguishing devices (such as an Ansul system) and suitable gas cut-off devices (manual and automatic), installing grease traps and taking all reasonable steps to prevent greasy substances from entering the waste lines of the building, and connecting kitchen drains directly to grease traps and the grease traps directly to the sewer or septic system.

Parking

In most jurisdictions, zoning ordinances require restaurants to maintain more parking spaces per square foot of building floor area than general retailers. Parking is sometimes available in nearby garages or lots, but this requires an agreement with a third party that may be costly and time-consuming to negotiate and document. Valet parking may require compliance with local ordinances. In mixed-use projects, the parking issues are complex due to the varying needs of retail and restaurant customers and employees, office workers, residents, and their visitors (see Parking Clause (Restaurant Lease, Office Building). Make sure there is a provision ensuring adequate signage directing patrons to your client's restaurant. The lease should require the landlord to maintain a specified number of conveniently located parking spaces for use by tenant's customers (including for pick-up customers, if applicable). However, most shopping center leases do not provide meaningful parking protections for the restaurant tenant. If the landlord charges for parking, try to negotiate free or reduced rates for the tenant's validated customers.

Rules and Regulations

Some leases have separate permitted use clauses and operations / restrictive covenant clauses while other leases will combine them. (See Permitted Use Clause (Restaurant Lease, Office or Retail Space) (Pro-Landlord).) Regardless, be sensitive to the landlord promulgated building (or shopping center) rules and regulations, which are often annexed as an exhibit to the lease, or sometimes which, disarmingly, without any specificity, are simply referred to as rules "adopted now or in the future." In either event, make certain that your carefully negotiated permitted use and operations provisions are not materially impacted by the more boilerplate (but equally binding) building rules and regulations.

Key Lease Provisions – Rent and Operating Expenses

Percentage Rent

Landlords in shopping centers, high-end hotels and other settings that the landlord believes provides an environment favorable to enhanced sales for the restaurant tenant, often want to share in a tenant's financial success. The usual vehicle for this (beyond a higher fixed rent) is a percentage rent provision by which the landlord will receive, in addition to the fixed rent, a percentage of a tenant's gross sales. See Percentage Rent Clause (Restaurant Lease, Shopping Center). Beyond the obvious financial ramifications, the tenant should understand that this arrangement brings the landlord closer to becoming the tenant's partner with invasive consequences the impact of which should not be minimized.

The percentage rent formula is relatively straightforward: if the tenant's gross sales increase over a certain amount (commonly called the "breakpoint"), the landlord receives a

designated percentage of such excess gross sales. Usually, a "natural breakpoint" is used, which is the amount of gross sales that, when multiplied by the applicable percentage, equals the amount of the annual fixed rent. For example, assume the applicable percentage is 5% and the annual fixed rent is $100,000. The provision would state that the tenant will pay percentage rent equal to 5% of the tenant's gross sales over the natural breakpoint, which in this example would be $2,000,000 ($2,000,000 ÷ 5% = $100,000). Therefore, in addition to the $100,000 annual fixed rent, the tenant would be obligated to pay to landlord 5% of its gross sales in excess of $2,000,000. Counsel should be aware that because many tenants will be profitable at a lower gross sales level than the natural breakpoint, a landlord may try for a lower breakpoint. Depending upon the tenant's projections, the tenant might counter by agreeing to pay a fixed rent greater than the location warrants in return for a higher breakpoint.

From a drafting perspective, it is essential to carefully define the types of sales that will be included and excluded (e.g., sales tax, tips, etc.) in the calculation of gross sales. See Paragraphs ___.02 (a) (for items included in the definition of sales) and ____.02 (b) (for excluded items) in Percentage Rent Clause (Restaurant Lease, Shopping Center).

Also, the customary radius restriction (especially in the shopping center context; prohibiting tenant from operating another restaurant within a specified area so as prevent the diversion of revenue to another restaurant, should be limited in scope, and should apply only to competing-style restaurants. (see Paragraph ___.02(c)). You can also expect a provision requiring the tenant to continuously operate the premises and to permit the landlord to audit the tenant's books and records (see Paragraph ___. 04). Try to obtain an undertaking by the landlord to keep all disclosed financial information confidential (with certain customary carve-outs such as disclosure to landlord's accountants, current or prospective lenders or prospective purchasers).

Operating Expenses

Shopping center tenants and mixed-use project tenants can expect to pay their proportionate share of the landlord's operating expenses (sometimes referred to as common area maintenance, or CAM expenses). Tenant's counsel should carefully negotiate the exclusion of items that are not properly the tenant's responsibility and, if possible, a maximum annual increase in the operating expenses. For examples of items commonly included and excluded from the definition of operating expenses see Paragraph 3.A in Retail Lease Agreement (Long Form).

Allocating operating expenses in a mixed-use project can present an especially challenging undertaking requiring enhanced diligence on the part of the tenant's counsel. The project's Declaration of Covenants, Conditions and Restrictions will provide for operating expenses to be allocated among the office, residential and retail users pursuant to a negotiated formula, with the retail components' operating expenses being further allocated between retail stores and restaurants. Because retail (including restaurant) tenants generally pay a straight pass-through of operating expenses (whereas office tenants pay only increases over a base year, and apartment tenants pay a gross rent without operating expenses), landlords have an incentive to shift as much of the operating expenses as possible to the retail component. Prospectively, advise your client to carefully review the annual statements of operating expenses. Landlords sometimes ignore (whether intentionally or inadvertently) specific operating expense exclusions in your client's lease which are not uniform to other leases, and therefore overcharge your client. To that end, make sure your client has the right to perform annual audits of the landlord's books and records pertaining to operating expenses. Be resistant to any provision which would limit the tenant's right to challenge an operating expense billing by requiring an objection to be interposed within an artificially short period.

Other Key Lease Provisions

Tenant's Improvements

The tenant's improvements and non-cosmetic alterations will be subject to the landlord's approval and compliance with applicable law. However, the tenant should try to obtain in the lease the landlord's approval (based upon preliminary sketches and renderings) of at least the concept and theme of the restaurant. The architect's formal plans setting forth the more technical embodiment of those concepts would remain subject to the landlord's approval. A detailed work letter specifying which aspects of the tenant's alterations the landlord is responsible for performing (including the specifics of the materials to be used) should be annexed to the lease. Similarly, a detailed description of the work tenant is obligated to perform should be set forth in an exhibit to the lease. Generally, if the landlord has granted an allowance for all or part of the tenant's work, the allowance will already be factored into the amount of the fixed rent. Note that the disbursement of the work allowance is usually subject to certain rigid guidelines (see Tenant Improvement Clause (Restaurant Lease)) and that it is not uncommon for a landlord to seek to recoup its work allowance (as well as brokerage and legal fees) should the tenant later default.

Rent Commencement

Rent commencement and the opening of the restaurant should not be tied to fixed dates; the process of securing permits and completing the buildout can be delayed for many reasons often beyond the tenant's control, especially when ensnared in the bureaucratic quagmire that is common in larger urban areas. The tenant should agree to use only "reasonable efforts" to complete the tenant improvements and to commence operations as soon thereafter as possible, but this is not usually acceptable to the landlord. If not, try to compromise by establishing a timeline for actions required of landlord and tenant, considering the interplay between the respective efforts of the parties and the time necessary for final municipal inspections and signoffs.

Insurance-Related Concerns

It is not uncommon for a lease to contain internal inconsistencies between the insurance coverage provisions and other insurance-related provisions (e.g., subrogation, indemnification, casualty and release and waiver clauses). These inconsistencies can result in unintended uncovered risks that might not become apparent until a casualty is experienced and a claim is interposed and rejected by the carrier. Unless the tenant's counsel is very sophisticated in this area of practice, it is strongly recommended that counsel immediately forward the lease draft to tenant's insurance agent or risk manager for a comprehensive review of these provisions.

For further discussion see Insurance Considerations in Commercial Leasing (Tenant) and Indemnity and Other Risk Allocation Mechanisms in Commercial Leases.

Security Interest

The lease (or applicable law) may grant the landlord a security interest in tenant's FF&E which would allow the landlord to sell the FF&E if the lease is terminated. To allow tenant the flexibility of leasing or financing the costly FF&E, the lease should require the landlord to sign an agreement granting the financing company a security interest.

Non-Disturbance Agreement

Your client's lease will generally be subordinate to the interests of certain superior interests (typically the landlord's lender). In addition, many leases provide that in the event of a foreclosure by the lender, the tenant must "attorn" to the lender, but only if the lender so requires. If the lender opts not to recognize your client's lease, your client might find itself dispossessed with the almost total loss of its substantial build-out costs. Thus, depending upon the magnitude of the buildout and the bargaining power of the tenant, a tenant should forcefully negotiate for a form of non-disturbance and attornment agreement. This is an agreement between the tenant, the landlord and the landlord's lender which makes it obligatory not only for the tenant to attorn to the lender, but for the lender to recognize the continuing validity of the lease. This agreement can be very complex as the lender usually seeks to impose limitations upon certain of tenant's rights under the lease. The tenant's counsel should try to make the delivery of the agreement an express obligation of the landlord, either upon execution of the lease or within a stated time thereafter. However, many landlords will only agree to use commercially reasonable efforts to obtain the agreement, or may be entirely resistant if the tenant is a small tenant, especially in a multi-use project or shopping center. Often, a tenant's obligation to attorn is expressly conditioned upon lender agreeing in writing to recognize tenant's lease. For further discussion, see Provisions in a Subordination, Non-Disturbance, and Attornment Agreement.

For an annotated subordination clause see Paragraph 20 in Retail Lease Agreement (Long Form); see also, Subordination, Non-Disturbance, and Attornment Agreement (Construction Loan).

Exit Strategies

Although a lease is negotiated during a time of great optimism, the high failure rate of new restaurants cannot be ignored. If your client's restaurant is not successful, then it needs to be able to close with a minimum of financial pain. Thus, it is essential that counsel provide exit strategies for the client. One of the most valuable rights in this regard is the ability to assign the lease in conjunction with the sale of the restaurant (either by stock or asset sale). (Subletting is another option. However, because in a subletting arrangement the original tenant remains the direct tenant under the existing lease and no privity of contract is created between the subtenant and the landlord, it is a less desirable option.) This is often the only way to recover the cost of the tenant improvements, including permanent fixtures such as cooking systems and walk-in coolers. Even if the lease allows it, the cost of removing improvements and fixtures, and restoring the space, is generally prohibitive.

Not surprisingly, the landlord will want some degree of control over a possible assignment to a new tenant. The landlord's conditions for approving an assignment should be specifically enumerated in the lease. At a minimum, the landlord should not be able to unreasonably withhold, delay or condition its consent to the proposed assignment. To provide some objective standard as to what is "reasonable," counsel should negotiate for a set of criteria to be included (even though the application of the criteria to a particular

assignment is still subject to subjective application by the landlord). Such criteria are likely to include that the proposed assignee must have financial standing, character, business reputation and experience as a restaurateur, at least equal to that of the existing operator. (See alternate provision to subsection (a) in Assignment and Subletting Clause (Commercial Lease) (Pro-Landlord).

In some situations, including a transfer by tenant to a successor entity (often defined to include affiliates, merged and consolidated entities), a landlord may be amenable to allowing an assignment without the need for consent. You should try to expand this category to include a transfer to a bona fide purchaser of all or substantially all the assets or stock of the tenant. The landlord may be amenable provided the foregoing criteria also are satisfied. Counsel should be cognizant that in many jurisdictions, absent contrary language in the lease or assignment documents, the assigning tenant will remain liable to the landlord should the assignee default. Also, be mindful of any existing personal guaranties and make sure to include a provision allowing a reasonably acceptable new guarantor to replace the original guarantor.

Should the landlord insist on a provision requiring the tenant to share with the landlord a portion of any consideration received from the assignee, negotiate for all unamortized improvement costs and assignment transaction costs (e.g., brokerage and legal) to first be deducted, and try to limit landlord's share to no more than 50%.

Disposition of FF&E.

Leases generally provide for the disposition of the FF&E at the end of the term. However, because restaurant FF&E is often substantially more valuable than the racking or display cases of normal retailers, the surrender provision is often more heavily negotiated. A restaurant tenant may want to retain its FF&E to sell or to use at other sites, while the landlord may want to keep the premises as a restaurant and use its presence as an inducement to a prospective tenant.

Additional Considerations for Restaurants Located in Shopping Centers

If the restaurant is located in a shopping center, the following issues should also be addressed in the lease.

Access and Signage

Common areas inside shopping centers are often cluttered by small kiosks, carts, massage chairs, and other sources of ancillary revenue. The lease should identify the main access areas to the restaurant from all parking and other common areas, and the landlord should not be permitted to obstruct, relocate, or close these access routes. The lease should provide the tenant with the right to directional signage at various locations in parking and other common areas. The tenant should be included on all mall directories and print and electronic advertising.

Remodeling and Renovation

The shopping center will be remodeled occasionally, and the tenant may suffer some loss of business during the renovation period. The lease should reasonably protect access and visibility during remodeling. The landlord will usually offer a rent reduction for the inconvenience caused, but the tenant should push to be reimbursed for lost sales (to the extent tenant can establish that a decline in sales is the direct result of the remodeling).

If the tenant must agree to a relocation clause, try to limit it to where the shopping center is to be remodeled or expanded. The landlord should pay all costs to construct a similar restaurant, as well as all other expenses of relocation. Any new location should have similar pedestrian traffic. If the new space is larger than the original space, the tenant should not pay rent on the additional floor area.

Deliveries

Although restaurants may be required to share loading docks with other retailers, restaurant deliveries should be given priority as they are usually small and can be unloaded quickly. Restrictions on hours of deliveries should be carefully negotiated, especially as restaurants receive perishable foods. The landlord will usually provide shared trash facilities. The tenant should make sure these facilities are adequate and located far enough from tenant's restaurant that they cannot be smelled. Restaurants produce more trash than other retailers, so landlords may require restaurants to bear a higher percentage of trash costs than retailers.

Considerations for Restaurants in Located in Hotels

Although a detailed discussion of restaurant leases in hotels is beyond the scope of this practice note, the tenant's counsel should be aware of the following basics when negotiating a restaurant lease in a hotel. If your client will operate in a well-known, high quality hotel, determine whether it is important to your client that the hotel remain

operating under the same prestigious brand. If so, then the lease should expressly require continued operation under that brand (or a comparable brand).

In most hotels, a restaurant tenant will be expected to provide high-quality room service, in some instances, 24 hours a day. Although the restaurant tenant will prepare the food, the hotel should provide personnel to deliver the orders and retrieve the trays, with the cost of the hotel personnel often charged back to the restaurant. Because of the potential liability involved, entry into guest rooms should always be left to hotel staff.

Hotel restaurants are typically obligated to allow guests to charge meals to their rooms. The lease should require the hotel to verify the diner's signing privileges and credit limits upon request, after which risk of collection should pass to the hotel. The tenant may be required to provide food and beverage "comps" to certain hotel guests. The tenant typically wants to be reimbursed at the full menu price (plus sales taxes and gratuity), while the landlord usually does not want to comp the full amount (especially with respect to expensive wines). The tenant may also be required to provide discounted meals to on-duty hotel employees. If so, there should be an agreed-upon percentage discount, as well as a monthly dollar limit. If the tenant is expected to cater events in hotel facilities, or if the tenant desires to cater events outside the hotel, then the details are usually set forth in a separate agreement. Catering agreements should include any fee the tenant must pay to the hotel for the use of kitchen facilities to cater non-hotel functions.

Michael B. Kent, Senior Partner, Kent, Beatty & Gordon, LLP

A founding partner of Kent, Beatty & Gordon, Michael brings a rich, diverse background to his practice that includes real estate, commercial litigation and arbitration, business counseling and advice, as well as entertainment law.

Michael began his career almost forty years ago at a small, politically influential New York law firm. In 1981, he opened his own practice, which subsequently evolved into Kent, Beatty & Gordon, LLP. Over the years, Michael has served as litigation counsel in several high profile matters ranging from the Iran-United States Claim Tribunal to the first major sports agency scandal. More recently, Michael headed the internal investigation of a shooting incident involving a New York-based National Football League player.

Like the other partners of Kent, Beatty & Gordon, Michael's expertise lies in assisting clients in making difficult decisions – often outside of mainstream practice - and implementing the solutions. He is adept at identifying legal issues and practical considerations that often help his clients defuse controversial matters before they reach the courthouse – and the media.

Michael heads the firm's real estate practice, handling commercial and residential real estate matters, including conveyances, leasing, zoning and land use, financing and construction. He is a frequent lecturer and writer on real estate law, most recently authoring the *Lexis Practice Advisor Journal Note* entitled "Negotiating and Drafting Restaurant Leases" (2018).

Michael's entertainment practice is extensive, with a client list that includes prominent musicians, composers, managers and producers, among them several Grammy Award® and Academy Award® recipients.

He recently was appointed to the Advisory Board of Directors of Customers Bancorp whose subsidiary, Customer Bank, is an $11 billion state-chartered full service bank with branches and offices throughout the northeast.

Michael served as the Village Justice of Thomaston in Great Neck, New York for more than a decade, and as an adjunct professor of litigation studies at Long Island University and Mercy College.

Although proud of the many long-standing relationships he has maintained with the firm's clients, both individual and corporate, Michael remains dedicated to nurturing new client relationships.

He is a member of the New York State Magistrates Association, the American Judges Association, the Association of the Bar of the City of New York, the Nassau County Bar Association and The American Bar Association. He is admitted to practice in New York and the District of Columbia, in the U.S. District Court for the Southern and Eastern Districts of New York, and in the U.S. Court of Appeals for the Second Circuit.

"If swords must be crossed in a court of law – so be it. But my greatest professional satisfaction is derived from fostering an environment where reason can prevail allowing my client to realize a proper and more rewarding resolution."