Issues Unique to Restaurant Leasing: If You Can't Take the (Legal) Heat, Stay Out of the Kitchen

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RESTAURANT LEASES present many of the same issues found in other retail settings. For example, any careful tenant, restaurant or otherwise, should always perform a due diligence investigation of the premises to be leased and the project in which it is located, including review of: (a) all documents of record for such matters as restrictions on use, pass-through costs, and parking restrictions; (b) the survey; (c) the Phase I environmental report; and (d) the property condition report. Given that, many restaurant tenants find that the process from site selection until store opening requires significantly more time (often a year and a half to two years) and capital (often two to six million dollars) than traditional retail uses, thus due diligence is even more important. In addition to long lead times and a heavy financial outlay, restaurant tenants face a unique set of concerns exclusive to the industry, including significant and very specific utility requirements, sanitation and delivery issues, licensure and regulation issues, and a fickle market. When the success of a business can hinge on factors beyond the quality of the product or service offered and personal preference and taste—from location, sanitation, visibility, and access to hungry patrons—restaurant tenants have more complex issues to address. Landlords, in turn, want to maintain a greater level of control over restaurant leases for several reasons, such as the ability to formulate a desirable tenant mix and guest experience within their developments, that fact that they are dealing with premises that are challenging to retrofit to other uses, and the relatively high failure rates of restaurants. Many of these unique restaurant issues should be addressed at the letter of intent (LOI) phase, while others will play out through the lease negotiation process. This article reviews some of the core yet unique issues presented in restaurant leases and offers suggestions that parties can use to navigate the conflicts between landlords and restaurateurs.

CONTRACTUAL ISSUES IN RESTAURANT LEASING • Executing a lease is a significant commitment—typical leases for restaurants are a minimum of 10 years with at least two options of five years each. As such, parties entering into a restaurant lease should be aware of common issues in the restaurant setting that may govern how they run their business for years after the restaurant's opening and address as many of them as possible at the outset of the process.

Use Clauses

Landlords favor narrow use provisions in order to protect their ability to maintain a mix of tenants in their developments, including the types of restaurants operating therein. Ideally, Landlords prefer to attach a menu as an exhibit to a lease to establish the parameters of a potential tenant's use. From a landlord's perspective, the use clause should, at a minimum, specify the type of restaurant (e.g., quick service, fast casual, casual dining, fine dining) and type of cuisine offered (e.g., Mexican, Italian, American).

In order to protect its flexibility and provide an exit strategy (more important given the generally longer terms for restaurant leases), a tenant prefers a broad use clause such as "restaurant or any lawful use." Landlords hesitate to allow such flexibility for fear that a restaurant will become a nightclub, bar, or worse, a book store, when a dining establishment was what was intended and expected. However, having an agreed menu can limit innovation, even when a tenant is not looking to drastically change its use of the premises. Tenants therefore often prefer to define their permitted uses by the universe of matters that are not prohibited by other leases and title restrictions within the development. Depending on how the use clause is drafted, it may protect or limit the ability of the restaurant to undergo periodic changes in design or concept, changes generally desired by tenants to track market trends or adhere to franchisor requirements. What a lease states a tenant may or may not do at the onset will go far towards determining the extent of control a tenant has over its business over the life of the lease.

To reach a happy medium and to allow tenants to survive changing market trends, landlords will sometimes allow for an expanded use clause after operating for a period of time under a specified initial use, subject to any new prohibited or exclusive uses granted by the landlord since the lease was first signed. Another option for parties wanting to provide the tenant some flexibility is to limit the percentage of sales or square footage of the premises which are devoted to the new use (with reporting requirements for verification). If a tenant is unable to obtain sufficient flexibility in its use clause, a tenant may try to include a right to terminate the lease if its business does not generate a threshold amount of sales. Both parties must navigate the tension in limiting the use clause and allowing for a successful business.

Exclusivity

Similar tensions exist with respect to exclusivity. Restaurants are territorial in nature. For example, a high-end Italian restaurant will not want another high-end Italian restaurant (or, for that matter, any other high-end restaurant) nearby and, therefore, may want to restrict landlord's property for such uses. It is in the tenant's interest to obtain an exclusive right to a portion of the restaurant market, either to become "the" restaurant in the area serving its type of food, or to reap the benefit of having established a thriving market by opening another restaurant near their existing one. Finding an acceptable compromise of exclusivity is important to allow a restaurant to remain popular and attractive in a competitive market.

Crafting exclusive clauses requires a balancing act to make the clause narrow enough to both allow landlord the flexibility to lease the rest of its property and be enforceable, yet broad enough to protect tenant's intended use, as the same may evolve. Landlords should be careful to limit the protected use to the type of restaurant (e.g., fast food, sit-down) and to clearly define the protected items (e.g., if the items are sandwiches, what is a sandwich?). Exclusive provisions should also be descriptive enough to capture a niche or novel cuisine, such as fusion, or specific enough to eliminate competition from an actual named competitor and not just any restaurant that serves the same type of food to a different customer base. Allowing a tenant the protection of an exclusive use may encourage other tenants to request similar protections, thus extending the list of prohibited uses for future tenants ad infinitum. Because of this, and to allow flexibility for changes of use, landlords must carefully keep a specific list of all exclusive and prohibited uses within their leases and title restrictions.

White City Shopping Center, LP v. PR Restaurants, LLC, No. 2006196313, 2006 WL 3292641, at *1 (Mass. Super. Ct. Oct. 31, 2006) highlighted the difficulties of crafting an effective exclusive use provision while ensuring new tenants do not violate an exclusive use right. *White City* concerned the exclusive granted to Panera Bread, a restaurant in the subject shopping center selling sandwiches and soups. The clause stated "Landlord agrees not to enter into a lease, occupancy agreement or license affecting space in the Shopping Center or consent to an amendment to an existing lease permitting use … for a bakery or restaurant reasonably expected to have annual sales of sandwiches greater than ten percent (10%) of its total sales or primarily for the sale of high quality coffees or teas, such as, but not limited to, Starbucks, Tea-Luxe, Pete's Coffee and Tea, and Finagle a Bagel." *Id*. at *1. The lease contained no definition of "sandwich" and only listed several chain restaurants who would be prohibited based on the exclusive. When Qdoba, a Mexican-themed fast food restaurant that sells burritos, tacos, and quesadillas leased space in the shopping center, the landlord sought a declaratory judgment stating that the sale of burritos, tacos and quesadillas did not violate Panera's exclusive use. Panera responded by filing a preliminary injunction to block Qdoba's operations, claiming among other things, a breach of contract, breach of implied covenant of good faith and fair dealing, and a violation of the consumer protection statute. The court, in denying Panera's motion for a preliminary injunction and finding the exclusive use provision undisturbed, noted Panera's lack of specificity and forethought in crafting the provision. It stated, "[b]ecause [Panera] failed to use more specific language or definitions for 'sandwiches' in the Lease, it is bound to the language and the common meaning attributable to 'sandwiches' that the parties agreed upon when the Lease was drafted." *Id*. at *4. The ordinary meaning used by the Court, undefined by the parties, was the dictionary definition of a sandwich: "two thin pieces of bread, usually buttered, with a thin layer (as of meat, cheese, or savory mixture) spread between them." *Id*. at *3 (citing The New Webster Third International Dictionary, 2002). Burritos and tacos did not meet this definition, and thus the court did not deem Panera's exclusive use to have been violated.

To circumvent some of these problems, as illustrated by the *White City* case, parties should carefully craft specific language defining what is and is not included in the exclusive use. A landlord should include carve-outs for existing tenants (and their successors and assigns), anchor stores, incidental uses (e.g., serving pastries in a full-service restaurant would not violate a bakery's exclusive use), and tenants over and/or under a certain size. Other issues to address in an exclusive clause include:

- Does the exclusive remain in effect in the event of an assignment or sublease;
- Does the exclusive remain in effect if tenant ceases to operate;
- Does the exclusive remain in effect during any extension periods;
- What should be the remedies for a breach by landlord and should they depend on whether or not the breach was intentional; and
- Should the agreed-upon remedies for breach of an exclusive be in lieu of all other available remedies?

Specified limitations on exclusive use restrictions provide certainty for both parties and enhance enforceability. Exclusives can be limited by geography—the food court, only one corridor, or the portion of the center which the landlord owns—or they can consist of a radius provision that prevents the leasing of property by landlord within a restaurant's market. Exclusive use clauses can prohibit specific named tenants or chains, be limited to a specific per person check average (PPA), and/or delineate between uses where alcohol is permitted and where it is not (and can even include gross sales percentage guideposts to distinguish between restaurants and bars, for example).

Although most states' laws require operators to track sales of alcoholic beverages in detail, the same may not be true when it comes to regular menu items. One method often used is to state that a competitor will not derive gross sales in excess of a stated amount from the protected items. This test comes with risk, though, including the possibilities that restaurant operators may not account for gross sales on an item by item basis, may not accurately or timely report, etc. An alternative would be to limit the number of protected items on a competitor's menu.

While exclusive use provisions protect the restaurant's business, they open the door for landlord liability. Landlords often worry about antitrust claims and seek to pass the risk of such a claim to the tenant by requiring that either tenant forgo the exclusive or indemnify landlord for any antitrust claims made against landlord in connection with the granting of an exclusive. Aside from a landlord's liability for its intentional breach of an exclusive granted by landlord, a landlord may be liable for the actions of another "rogue" tenant that breaches the protected use, potentially requiring the landlord to institute enforcement proceedings against the violating tenant yet wanting to otherwise keep the violating tenant in the project. Remedies for violation of an exclusive may include liquidated damages and/or a right to terminate the lease with a potential investment reimbursement, reductions in rent, or equitable remedies, all of which can have ramifications on the landlord's financing and investors. A landlord concerned about some of these potential issues can sometimes be persuaded to nonetheless grant a tenant exclusive use protection if the tenant agrees to limit the length or severity of the remedy, such as: (a) rent abatement in proportion to the demonstrated decreased earnings; (b) a specified time period in which the tenant may exercise the remedy and after which the tenant either continues despite the breach or terminates the lease; or (c) liquidated damages serving as the sole remedy.

OPERATION, HOURS, AND MAINTENANCE • As mentioned above, opening a restaurant often entails a more significant expenditure of time and money as compared to other retail uses.

When negotiating the letter of intent and drafting the lease, the parties must be clear as to the condition of the premises for delivery to the tenant, conditions precedent to the tenant's obligations to commence construction and/or pay rent, tenant build-out periods (especially if tenant work will begin while the landlord is still performing work near, or even in, the premises), and any remedies if the foregoing are not met. Parties should seek to negotiate leases that explicitly allocate risk, state specific timelines and responsibilities to ensure deadlines are met, and set forth what remedies, if any, should be available to the non-breaching party.

Landlords will want a covenant compelling a tenant to construct and open within a specified time frame, followed by a continuous operating covenant for the entire term (especially when the lease contains a percentage rent component). However, if a landlord is confident in the credit of the tenant, it may require the tenant to perform its tenant improvements and open at least one day fully stocked and staffed, but then agree to a reduced operating covenant that includes a right for the landlord to recapture the premises if tenant ceases to operate for a defined period. In such instance, landlords might consider a recoupment of its investment costs or requiring the tenant to surrender its furniture, fixtures and equipment (FF&E) upon termination or recapture.

A tenant may wish to defer construction, and thus opening, until a special time of year or a specified percentage of other stores in the project are open. If the landlord grants the tenant an opening cotenancy right, and the required cotenant are not open, it may be better for the parties to provide for reduced rent until such time that the required cotenant are operating, such that the tenant is at least open and operating for business.

Each party will understandably also want to defer its construction obligations until the other party's contingencies have been satisfied or waived. In addition to standard construction contingencies, however, restaurant leases need to address contingencies such as the existence of proper zoning (especially if the restaurant is located near the water), the ability to obtain a liquor license, and the availability of sufficient utilities in order to establish a clear critical construction path. If proper zoning does not exist, then during the LOI phase, the parties should research the approximate amount of time the zoning process is expected to take and agree which party should take what action to obtain a zoning change or variance. At the same time, the tenant should engage local liquor counsel to answer questions such as: (a) what are the steps required to apply for the license; (b) how long does it usually take to compile the information required for the application; (c) what jurisdictions have to approve the application (e.g., state ABC, county, or local liquor board); (d) will the landlord have to be fully or only partially disclosed on the application; (e) how likely is it that citizens or competitors will protest the application; (f) if the license cannot issue until construction is complete, what lesser assurances can the tenant obtain to allow it to waive the contingency and begin construction; (g) are there quotas in place; and (h) if a license must be purchased, what is the cost and availability. Especially for new construction, the parties may want to obtain "will serve" letters (preferably identifying the capacity that will be delivered and a time frame for delivering the same) for electricity, gas, water, sewer, data, and more prior to being obligated to commence construction.

Frequently, the longer permitting and construction takes, the more likely it is that the tenant will face an obligation to pay "dead rent" where the rent commencement date begins before the restaurant opens. Therefore, carefully crafted timelines are essential to planning an opening. A tenant will want to tie a rent commencement date to the completion of certain events, delaying it as far as possible. For instance, a tenant can condition that rent payment begins when a liquor license or conditional use permit is issued. In such a case, the "what-ifs" must be addressed and an obligation included for the diligent pursuit thereof. What if a liquor license is not obtained? What if the tenant delays in submitting applications thus delaying receipt of licenses or permits? In restaurant letters of intent and leases, the best approach is to have a time line identifying each contingency and allocating responsibilities. This should involve not only lawyers, but also architects, engineers, contractors, persons familiar with licensing and the other non-legal issues.

Hours

Especially in mall and mixed use developments, the parties to a lease need to determine what hours the tenant is expected to operate, and when, if ever, it may deviate from the hourly operating requirements, and if such a deviation is allowed, at what cost? Will a brewery-themed restaurant be expected to serve breakfast, or can it remain open until midnight even if the project closes at 10:00 p.m.? Will a restaurant serving only lunch or dinner, or a bakery serving breakfast and lunch, not have to adhere to a project's required operating hours? This applies conversely as well, as tenants who wish to remain open past hours typically need permission to do so. In jurisdictions which restrict Sunday alcohol sales, must a restaurant which normally serves alcohol be open on Sundays to serve only non-alcohol items? Can a landlord force a restaurant tenant to open on Christmas or Thanksgiving?

Even if a location's operating hours are not tied to cotenancy concerns, if a landlord's rent is partially dependent on a tenant's sales, it will require a certain minimum number of operating hours per day or week. Tenants must review these required hours carefully to ensure (a) the hours the landlord demands are not longer than contemplated, requiring an expenditure of significant resources in time, labor, and cost of goods; and (b) the hours are not shorter than contemplated, potentially cutting into optimal times for tenant profitability. The tenant may wish to include a "go dark" clause that enables it to cease operations without defaulting, provided that the tenant complies with the other required terms of the lease. In such instance, landlord should consider: (a) a recapture right; (b) reimbursement for investment costs; and (c) the impact of the cessation of operations on other clauses in the lease such as effectiveness of exclusives and options. In addition, the lease should address temporary closures for events such as repairs, remodeling, or inventory, to avoid any unintended violation of the operating requirements. In such instances, landlords should consider limiting the number of days of permitted closure.

Tenants who remain open past normal center hours need the area surrounding their restaurant to remain attractive and safe for customers, which results in additional costs to either a landlord or tenant. Parties will want to clearly define hours and allocate increased costs necessary for things such as additional lighting, security, parking, and access. Parties should explicitly delineate who will cover the extra expense of any after-hours operations.

Installation, Maintenance, and Deliveries

Restaurants often require significant tenant improvements in order to both operate effectively and to attract customers. Even before considering design, the tenant must determine if the proposed premises can be built out to meet the restaurant's unique needs related to food preparation and service, heating, cooling, ventilation, and drainage. The parties should explicitly delineate responsibility for the installation, maintenance, and repair of the necessary equipment as well as who is responsible for the cost of the same, as the answer could be different.

Due to cooking and occupancy numbers, restaurants require extensive heating, ventilation, and cooling equipment. Landlords or local jurisdictions may require tenants to install vents or circulation systems to capture and contain exhaust or odors which would otherwise emanate from the restaurant. Tenants will want to include provisions in the lease allowing for normal odors associated with the operation of a restaurant.

Venting requirements pose particular problems in multi-storied centers or office buildings where structures above a restaurant make installing a direct venting system to a rooftop impossible. Landlords are often in the best position to undertake the necessary weaving of multi-story ventilation, though tenants may bear the cost and should prepare accordingly by assessing any challenges in ventilation installment. In such cases, the tenant will not only want to confirm the fire rating of the chase, but if it will be obligated to clean the grease out of a multi-story chase, it will also want to understand the route and ensure that its cleaning contractor will have proper access to all parts thereof.

Restaurant tenants, unlike any other retail tenants, produce a substantial amount of fats, oils, and grease (FOGs) which need to be captured by grease traps. The lease needs to address who and how and where the grease trap is installed and at whose expense. These grease traps require proper maintenance to avoid backups causing major damage to a tenant's premises and the landlord's property. Traps need to be cleaned monthly or quarterly and the responsibilities and liabilities should to be clearly assigned. Landlords will usually insist that the tenant install and maintain the grease traps and assume liability for clean up if the tenant fails to maintain the same. If a grease trap services more than one tenant (such as in a food court or where accessible space is very limited), the landlord should maintain the grease trap and pass the cost through to its users. To ensure maintenance of the grease trap, a landlord may require the tenant to obtain a preventative maintenance contract and deliver copies of the periodic invoices. FOGs don't all stay in the kitchen and flow into the grease trap, however. Used cooking oil is usually put in a recycling bin for periodic removal. Will the cooking oil end up where intended if the bin is full or if an employee has to carry a heavy bucket of cooking oil past the trash compactor on a cold night to get to the bin? Landlords and tenants may also want to agree upon the location, logistics, and servicing of a used oil recovery system.

In addition, if a space is not already suited for restaurant use, it may be appropriate to have a waterproof membrane installed to protect against leakage. Who will install and maintain the membrane and who will bear the cost will be the subject of negotiation.

Restaurant tenants also produce high volumes of refuse, and both parties will want to ensure that there are adequate facilities available. Landlords may require garbage to be removed daily to prevent an accumulation of the same and to minimize the odors, animals, and pests associated with restaurant trash. Trash removal paths should be designed so that common areas are kept free of its removal or transport. Generally, a tenant will want a convenient location and a safe path to access dumpsters. In many buildings and centers, there may be prohibitions on leaving trash in service hallways or limitations on the use of compactors, both of which a tenant should consider when entering into the lease. Tenants may prefer to have trash removed by their own contractors, or removed for a cost not above what they could contract for directly. As one might suspect, food refuse attracts pests. The parties should designate the minimum requirements for pest control, by whom it will be performed and at whose cost.

Tenants serving food will want the ability to receive frequent deliveries of perishable goods at any time and location to ensure adequate and early stocking. Landlords will want to limit deliveries to late at night or early the morning, and restrict delivery to the back of the restaurant to maintain decorum near storefronts. Restaurants in urban mixed use developments may need special delivery permits or even to have special loading zones designated by local authorities. Parties should plan specific allowances for delivery times and access that are in line with the heightened needs of a restaurant and the other tenants of the development.

Alterations and Improvements

In addition to determining that building systems such as HVAC and grease traps are suitable and that operational issues like waste and deliveries can be satisfied, most restaurant operators will want to install furniture, fixtures, and equipment or remodel the premises to attract customers, provide restaurant services, and even comply with franchise requirements. This can include extensive kitchen equipment, walk-in coolers, a bar and gantry, booths and tables and other items. The LOI should contemplate reciprocal plan generation and approval prior to either party beginning construction, and the lease should carefully address the plan approval process so that landlords can have the right to review and consent to material alterations to their property both at initial build-out and for subsequent improvements.

Signage is the lifeline to any restaurant. Tenants want to identify their restaurant and should be aware of any limitations on signage imposed by the landlord, documents of record or any governmental agency. Landlords may find that a tenant's typical signage detracts from the visibility or image of the property and impose limitations on its design, size, or use. The LOI should set forth the location and size of the signage. If the restaurant is part of a chain, deference may have to be expressly given in the lease to signage designs implemented within that chain or system. If possible, the parties should attach shop plans for agreed upon signage as an exhibit to the lease and address their respective rights regarding additional signage within the development.

For tenants wishing to install satellite TV or cable, the control over the installation, removal, and eventual ownership of the equipment will need to be established. Landlord form leases usually prohibit attaching a satellite or antennae or anything else to rooftops. Reasons for this include that landlords want to limit the equipment which is visible to passersby, as well as the weight and the noise the equipment produces outside the premises, potentially prohibiting its use entirely. Of great concern to the landlord is the need to ensure that its roof warranty is not voided by allowing access or installations on the roof. In many cases, tenants are now able to weight down or attach satellite dishes to the roof in a manner which does not actually penetrate the same. If roof penetration is required, however, a tenant may be required to employ landlord's contractor to install the necessary equipment at the tenant's cost. Using the contractor who installed the roof usually will retain the validity of the roof warranty and thereby enable a tenant to avoid liability for any damage that occurs during installation. Even if the tenant employs the landlord's contractor, the landlord may require a warranty or indemnity for any impact such equipment has on the roof. The lease should clearly address removal obligations and whether landlord can impose a separate charge to operate a satellite or cable TV.

Landlord lease forms typically claim a contractual lien on tenant's FFE and other personal property either as security for unpaid rent or to help with re-leasing the premises following the termination or expiration of the lease. Some states grant landlords a statutory lien on their tenant's property. Restaurant tenants frequently resist these liens because they interfere with their lenders' rights, could potentially embolden a landlord seeking to exercise remedies, and because most of the FFE has very little, if any, resale value anyway. Tenants with equipment leases or financing should at least require a subordination of any landlord's lien to the rights of tenant's equipment lender. The exercise of those rights should be limited, however, and a landlord should be indemnified for any damages it sustains as a result of the lender's acts when enforcing its rights.

The restaurant business involves substantial investment in improvements such as hoods, walk-in coolers, bars, sinks and prep stations, and built-in refrigerators, and the lease should expressly spell out whether or not such items are to be removed at the end of the lease term. A landlord may benefit from requiring attractive, well-built additions remain upon a tenant's departure. However, a landlord may want the right to require that the improvements, including kitchen and telecommunications equipment and cables, be removed, and the premises de-identified to avoid assuming costs of removal down the road, particularly when a new tenant may not be a restaurant. If a tenant desires to sell or remove trade fixtures to a new location upon lease termination, the lease should explicitly reference the removable property and/or define what constitutes a trade fixture so as to ensure a landlord cannot force any such item to remain.

Parking and Drive-Throughs

Restaurants have higher parking requirements than most other retail uses, especially during peak days and hours, so adequate and convenient parking is essential to attracting and retaining business. A restaurant with excellent food but inadequate parking will lose customers or create an undesirable spill-over effect into neighboring businesses or residential areas, and thus become an unwelcome addition to the community.

A landlord may want to make specific parking spaces available to the tenant's patrons and employees to prevent a monopolization of a parking area shared by multiple users. Landlords may also consider allowing for short-term "to-go" parking spots. These temporary standing spots enable customers to pick up food without congesting parking near the restaurant.

Tenants will want to ensure that a lease allows as much parking as possible and perhaps even include a parking site plan as an exhibit to identify a protected parking field. Tenants who rely on parking as a part of their customer appeal should include provisions that reserve the right to approve changes in shared parking space, limit the uses of surrounding buildings, and include parking ratios. Restrictions on the location of staging areas for any future construction in the development as well as specific post-taking parking requirements in the condemnation clause can help ensure that the availability of essential parking will not be interrupted. Tenants may also desire to use valet parking, which can be especially helpful in reducing congestion for in-line spaces with multiple restaurants and under-parked developments. Tenants who require valet parking should inquire into local permitting requirements and incorporate them into the lease as appropriate. If valet service is allowed, flexibility should be included to allow for relocation if necessary. Landlords will want to control the location of the valet stand, the spaces where the cars will be parked, and the flow of traffic that the valet will create.

Before granting any of the foregoing, landlords need to carefully review all documents of record (including applicable reciprocal easement agreements [REAs] and covenants, conditions and restrictions [CC&Rs]) and existing leases (particularly anchor leases) to see if it can grant any particular parking rights to a particular tenant (e.g., valet parking, designated parking spots), and if the landlord can charge for the same, and if so, whether it can provide discounted or validated pricing.

For restaurants using parking areas later into the night, tenants will want to define when and where lighting is located, and provide for the ability to include additional lighting if necessary. Landlords may insist that a tenant pay for any expenses incurred in connection with use of parking areas beyond normal operating hours, including lighting and security. Tenants operating restaurants which remain open late should avoid lease provisions allowing a landlord to dictate where employees park or negotiate an exception to allow employees working late at night to park close to the restaurant rather than having to walk across an often dark and deserted development or parking lot.

Landlords allowing for a restaurant on a pad site must determine the impact of reduced parking capacity for the rest of its property against the benefit of increased business associated with the restaurant. Will the required parking ratio—whether imposed in documents of record or by governmental regulations—be maintained if an outlot is created? Is there an easement in place to allow guests to use adjacent parking and vice versa? Does the potential increased revenue to the landlord justify the expenditure of additional funds for constructing and maintaining additional parking lots?

The lease also should address any enforcement rights and obligations with respect to dedicated parking or restricted parking areas. Tenants may want the right to enforce dedicated parking by towing, but the negative impact on landlord's customers must be considered. A restaurant tenant will want control or a right to self-help over the maintenance of the parking area to ensure it is well kept, for instance plowed and in good condition. Landlords not only want the right to tow the vehicles of their tenants' employees who fail to park in designated employee parking, but frequently also want to be able to fine their tenants for the parking infractions of their employees.

If a tenant desires a drive-through, which typically requires conditional use permits, it may want to include a contingency provision in the lease to provide for a termination right if it cannot obtain the permit. In addition, prior to executing a lease, tenants will want to obtain assurance that a drive-through is permissible and not in violation of any existing recorded or unrecorded restrictions or governmental regulations. Landlords will want tenant to conduct their own due diligence and will avoid making any such representations with respect to the same. If a drive-through is permitted, landlords may wish to include provisions for traffic control to avoid congestion. Such provisions may require a tenant to hire staff to direct traffic or require the use of more drive-through window employees to expedite service. Landlords often will include provisions limiting the use of outdoor speakers or noise emanating from the premises for tenants who might employ a speaker or a paging system for a drive-through or for use by hostesses calling waiting patrons.

Patios

Patios are a boon for a tenant that wishes to attract customers while also increasing its serving capacity with a minimal impact on expenses. For landlords, properly placed patios can increase the possibility of the success of the tenant as well as have a positive impact on the surrounding property. Issues of appearance, rent, decorum and cleanliness, design schemes, and any interference with a property's normal access will need to be addressed.

The landlord will want the tenant to be responsible for all matters arising out of the use of the patio and have all provisions of the lease, including insurance and indemnity provisions contained therein, apply to the same. For that reason, even if the tenant is not being charged for base rent or common area maintenance (CAM) costs for the outdoor area, it is often best to include the outdoor area as part of the definition of the "Premises" for all other purposes. All documents of record, existing leases and governmental regulations must be reviewed before agreeing that a tenant can use any outdoor area for the service of food or beverages.

The landlord's desire to control the appearance of its property and the tenant's desire to control the appearance of its restaurant may create a conflict. A landlord may require adherence to a design or style of the larger project in which the restaurant is located, or otherwise have approval rights over design of the patio, including furniture. However, a tenant may be bound by franchisor requirements or want to maintain the same appearance as its other restaurants, and may be hesitant to concede to the landlord broad approval rights. The parties can often avoid a conflict by having the landlord approve the design and appearance elements early in the leasing process. A landlord will also want to limit the noise (including music) heard outside the patio area and prohibit the addition of any devices or equipment on the exterior of its building.

The use of a patio should always be subject to all applicable laws. Tenants should research any additional permitting and licensure requirements triggered by their patios, such as site plan disclosures and patio fences or enclosures required by liquor or other regulations. In addition, a landlord may impose restrictions on the use of the patio area, such as prohibiting food preparation and limiting the hours of use. A landlord's power to define the patio use may extend to what beverages and foods are served, the type of serving equipment permitted, required levels of staffing to prevent non-customer use of the area and the type of entertainment allowed (e.g., live or recorded music only). Provisions providing for sufficient cleaning and pest control, with a right to perform such duties absent the tenant's proper performance, should also be included in the lease.

Utilities

Utilities are essential to the operation of any retail business, but for a restaurant tenant, the cost and capacity of the same can prove vital to survival. Existing utilities, sewage, and water lines often do not have sufficient capacity or durability for restaurant use. For example, retail spaces are typically powered by 200 amps of electrical service, while a 7,000 to 10,000 square foot restaurant will often require 1200 amps (or more if gas is not available) to power appliances, coolers, and lighting. Drainage lines made of materials designed to carry water and standard refuse may quickly erode when constantly carrying sugar, acid, and alcohol-laden beverages.

Tenants should conduct due diligence during the letter of intent phase and include minimum capacity and location requirements in the lease for each utility. The LOI language can be as simple as saying something like, "The following utilities shall be available at the Premises: Electricity: 1200 AMP, 120/208V, 3 phase, 4 wire; Natural Gas: 4" line and 3,407.5 CFH; Water (potable): 2" line, 90 GPM; Water (fire protection): 6" line at the greater of Code pressure or 60 psi; Sanitary sewer: 6" line; 400 GPM; Storm sewer: 8" line; Telephone: 4" conduit; Television/Data: 2" conduit." The LOI or the lease should also articulate the location to where the utilities will be brought (e.g., stubbed out at the edge of the pad site or brought to locations indicated on the tenant's approved plans), and by which party. Entry points for gas lines can be hundreds of yards away from a tenant's site and someone must pay to bring the source to the premises. Tenant's due diligence should include investigating whether any moratoriums exist that could affect its construction or business, such as winter moratoriums on the construction of underground power vaults when the ground is frozen. In addition, tenants should determine if there are any existing tap-in fees, impact fees, or deposits to be paid, and if so, the lease should clarify who will bear those costs. A tenant should also be aware of any impact or high usage fees that its installations, upgrades, or general use will cause.

Identification of who is responsible for ongoing maintenance, repair and replacement of each specific utility is essential. If the tenant's irrigation for a pad site connects to the city water line at the street, the tenant should maintain that line, but who maintains the tenant's irrigation if it instead connects to the landlord's irrigation line? Are the underground water and sewer lines part of the common areas which the landlord maintains, or will the tenant be required to maintain them? A landlord providing utilities will want to ensure its tenant's increased demands can be met and delegate the additional costs for upgrades explicitly to the tenant. If the landlord is charged with the task of installing or bringing utilities to the restaurant premises, the tenant may want to include a remedies provision in the lease granting the tenant options including delayed rent commencement, liquidated damages, a termination right, and/or self-help if the utilities are not supplied by the deadline or in the required capacity or location. If a landlord installs the utilities, the tenant may want an engineer to certify the work. If a tenant performs the work, the landlord may require use of approved contractors. Both parties will want to review and approve plans and specifications with respect to the location and capacity of all utility lines. In-line premises may need easements or licenses to access parts of the shared building, such as a garage, roof or mechanical closet to maintain utilities that are exclusive to the restaurant.

To protect against disruption of business, the parties will want to establish procedures that protect a restaurant when work is required for a utility line that runs through its premises, such as the provision of generators, mobile phone and data services, or above-ground portable storage septic tanks intended for temporary use (often referred to in the industry as “frac tanks”). Tenants will want provisions that require coordination with the general manager for planned outages, expressly state when work can be performed by the landlord and, if necessary, that alternative sources of utilities be provided. Tenants may also demand remedies if there is interference with its business directly or indirectly caused by the landlord. When utilities are disrupted by a landlord, a tenant will want quick restoration and remedies such as self-help, compensatory damages, liquidated damages, or rent abatement. A landlord will want notice and an opportunity to cure and delayed effectiveness (e.g., remedies only available after 72 consecutive hours of interrupted service).

Alcohol/Ancillary Uses

With its high margins and appeal for turning dining out into social experiences, alcohol is an attractive option for restaurants to offer their customers. However, the increased regulation, cost and liability exposure that accompanies on-premises alcohol service and consumption should be addressed in both the LOI and the lease.

Understanding and complying with applicable liquor laws requires a great deal of due diligence early in the process. The tenant will want to identify any limitation the landlord or others may have on the sale of alcohol, whether imposed by governmental restrictions or contained in other leases or documents of record. For example, are there restrictions related to distance from nearby schools, churches, or hospitals from which alcohol may be sold? Can a license be held by an out-of-state entity or individual? Must the license be obtained in the name of an individual? There may be ancillary permits to obtain at the same time, such as pouring, late night (or late hour), caterer and DJ and entertainment permits. As stated earlier, the tenant should engage local liquor counsel during the LOI process to provide a detailed road map of the requirements and time line for obtaining the appropriate licenses and permits. Is the restaurant located in a “new application” or “transfer” jurisdiction? Both types involve application and disclosure to liquor authorities, usually including employee training, seating plans, submission of background checks and more, but an applicant in a “new application” jurisdiction must usually provide considerably greater detail, undergo more scrutiny, and pay a higher fee. On the other hand, if the restaurant will be in a “transfer” jurisdiction, the parties must identify a license that can be purchased, who will pay the price, and when the transaction will occur as compared to the construction and finish out of the premises. Will the landlord want to acquire a transferable liquor license to make sure future tenants will also be able to sell alcohol? Who will keep the license at the end of the lease term? Sometimes a tenant will buy a transferable license but then give the landlord a purchase option at the end of the term for a specified price. The parties should address these questions in the letter of intent.

The increased regulation inherent in the sale of alcohol is not limited in reach to tenants. Landlords must agree to cooperate with the tenant's efforts to secure a liquor license. The parties might agree, for example, that:

Landlord shall promptly cooperate with tenant's efforts to obtain and maintain all necessary governmental approvals for tenant to obtain the Liquor license and that the foregoing cooperation may include landlord's execution of one or more applications for the liquor license, the qualification of landlord as a licensee, and/or providing the appropriate governmental authorities with required background information on landlord and its principals to the extent required by law (any such information to be held confidential by tenant and used only for the purposes of obtaining such permits and licenses).

In some jurisdictions, leases entitling the landlord to percentage rent may constitute an interest in the liquor license and hence require full vertical disclosure of the landlord's entity and ownership structure. When opposition arises at the required public hearings, both the landlord and tenant should attend and be prepared to enter into agreements which address the concerns raised, such as security, noise, vibration, and odor.

A landlord's obligation to cooperate with liquor licensure doesn't end with the issuance of the initial license, but should instead continue throughout the term, including annual or periodic renewals. Some jurisdictions will only renew liquor licenses with proof of existing lease term for the duration of the renewed license period, so landlords and tenants in these jurisdictions should agree to make the lease term conform to the month and day the term of the liquor license expires.

Landlords should definitely require that the tenant maintain appropriate dram shop insurance. They may even require periodic evidence of alcohol training and certification by the tenant's staff. If a landlord is anticipating a restaurant and not a bar, it will want to limit the use of alcohol as ancillary to a restaurant's primary business, perhaps restricting the tenant's offerings or limiting sales of alcohol as a percentage of the tenant's gross sales.

TRANSFERS • As mentioned above, opening and running a restaurant is both costly and risky. Restaurant tenants, aware of potential failure, will want to include exit strategies in their leases. This is smart planning for tenants, but can conflict with a landlord's desire to control who occupies its property. A landlord will likely have entered into the lease with a tenant in reliance on the name and reputation of the tenant and the particular restaurant or brand and therefore wants the same right to determine who may follow the tenant into its property.

Because the typical landlord lease prohibits the assigning or subletting of the premises without the landlord's consent, the challenge will be to strike an appropriate balance between the landlord's desire to control its property with the tenant's need for flexibility. To address these issues, the parties will negotiate permissible transfers pursuant to which a tenant may assign or sublet its interest in the lease without landlord consent. These permissible transfers will typically be conditioned on the experience, qualifications, and financial wherewithal of the successor tenant. Regardless of whether a transfer is permitted or not, Landlords will always want the original tenant to remain liable for all obligations under the Lease following a transfer. A landlord may also wish to condition a sublease or assignment on the premises having the same use as the original tenant (perhaps even the same trade name for franchise transfers), however, for instances in which the transfer occurs because of a failed restaurant, this restriction is likely problematic for a tenant. Tenants can typically settle for exclusions from landlord consent for franchisor or franchisee assignments, financing, stock transactions, sales of substantially all of the tenant's assets and intra-company assignments.

Many restaurant tenants are franchisees, and their franchisors require a certain level of control over the lease and the restaurant to ensure that brand standards are maintained and the site remains in the franchise system, including the right to cure tenant defaults and the right to take an assignment of the lease back (and right to re-assign to another franchisee) in the event of a default of tenant under the franchise agreement. Most franchisors have lease riders covering these matters that their franchisees are obligated to include in their leases.

Given the tenant's investment in the property, including for example, expensive equipment, the need for financing is common and thus should be addressed. The willingness of a landlord to allow financing by a tenant, which is often prohibited by the definition of a transfer, is usually dependent on which party is financing the build-out and what rights the equipment lender requires. Even if the landlord is willing to allow for financing, the landlord may only agree to a subordination of its lien rather than a complete waiver. The landlord also may restrict what a lender can do upon a default under tenant's financing (e.g., limit the lender's right to replace the tenant, who has repair obligations following equipment removal or limit the lender's ability to auction the equipment from the premises).

A landlord may prefer to have the option to recapture the premises rather than allow a tenant to transfer (other than collaterally) its interest in the lease. Because the existing tenant will have made substantial investments in the property that make the space particularly conducive to operating a new restaurant, prior to a tenant agreeing to such a recapture right, the parties should consider a landlord obligation to pay tenant the unamortized cost of its enhancement of the space triggered by a proposed transfer which is not related to a default. The reverse may be true as well if landlord financed the build-out.

CASUALTY AND INSURANCE • As with all leases, the parties need to consider what will happen in the event of a casualty affecting the premises or the building or development of which they are a part. Because of the equipment and other fixtures in a restaurant, restoration and repair after a casualty is often more expensive than it would be for a non-restaurant retail space. The parties need to clearly define not only what insurance is required of each party, but how the proceeds of the insurance are disbursed in the event of a loss. The parties also need to address when their respective rebuilding obligations are triggered. For casualties affecting multiple spaces and/or common areas, a tenant may try to link its rebuilding obligation to the traffic generated by the center with a requirement that is triggered only once a specific number or type of tenants, or a specific square footage of tenants, are required to be rebuilt. Landlords, on the other hand, want tenants to rebuild immediately to end rent abatement rights, help satisfy rebuilding cotenancy requirements in other leases, and re-start gross sales for percentage rent purposes as soon as possible. Perhaps a happy medium is for a tenant's rebuilding obligation to begin immediately upon the landlord's repair of corresponding casualty, if any, to common areas and utilities such as interior mall space, HVAC and drive and parking aisles in the immediate vicinity of the premises (possibly excepting cases of catastrophic loss where a coordinated grand opening of the entire development is preferable). The parties can take a similar approach to their respective obligations following a taking by eminent domain.

High levels of regulation for restaurants, especially if they serve alcohol, mean more time and red tape in the rebuilding process. Greater down-time quickly translates into greater financial loss. Landlords and tenants should therefore share an interest in ensuring that the tenant carries business interruption insurance sufficient to cover the larger revenue and longer rebuilding period which correspond to restaurants.

Not surprisingly, kitchens, ovens, broilers, fryers and high overall utility usage bring with them a higher risk of fire or other casualty, and a landlord will expect a tenant to maintain the appropriate type and amount of insurance to cover any damage resulting from its operations. Tenants may be covered under a blanket insurance policy if they are a part of a chain, but a landlord may require additional individual policies as well. Leases often include clauses that prohibit the tenant from using the premises in a manner that would negate, or increase the cost of, the landlord's insurance. The parties should confirm that the tenant's intended use as a restaurant, and bar if applicable, will not increase landlord's cost of insurance.

POST-OPENING TERMINATION RIGHTS • We have already explored contingencies for restaurant leases that allow the parties to terminate prior to the commencement of construction or before the restaurant opens for business, including proper zoning, the availability of a liquor license, compliance with construction timelines and more. However, restaurant leases should also address unique termination rights that are available after the business has opened to the public. A tenant may want to include conditional clauses that allow an exit in the event a required license or permit is revoked for reasons outside the control of the tenant, such as suspension or non-renewal of a liquor license due to insufficient remaining lease term, the acquisition by the landlord of an alcohol distributorship, or a felony conviction by a principal of the landlord if the landlord owns the liquor license. The parties may want to provide for the termination of a lease in the event of an individual tenant's death or incapacity, or if unpleasant odors exist that are not easily eradicated. Ongoing cotenancy requirements may also include a termination right or rent reduction.

If a party's performance of any obligation is delayed by force majeure, the parties should allocate such risk in the lease. The force majeure clause should require the excused party to promptly notify the non-delayed party and may allow such non-delayed party to terminate the lease if the force majeure event has not been resolved within a specified period of time, such as 180 days. Acts of terrorism should be explicitly included or excluded under the force majeure exception.

Accessibility Issues

Restaurants are places of public accommodation and, as such, need to comply with the provisions of local, state and federal laws and regulations relating to accessibility for handicapped persons and the removal of architectural and communication barriers to accessibility, including but not limited to The Americans with Disabilities Act. A restaurant tenant needs to be aware that accessibility compliance is an additional cost for which it must account when budgeting its construction. Of particular importance in the restaurant setting is that bathrooms, bars, signage and menus, entrances/exits and parking areas are compliant. A restaurant lease needs to allocate the responsibility of access compliance (both within and outside the premises) and the cost thereof between the parties. Which party is responsible for ensuring that the restaurant's signage in the common area complies with current and future ADA requirements?

OTHER COSTS • Restaurant tenants in a development are frequently required to contribute to the CAM costs incurred by landlords in operating a development. When a restaurant is not paying a fixed CAM, it will want to include a cap on its first year costs and on future increases as well as a floor on occupancy to avoid paying for vacancy. From a landlord's perspective, because restaurant tenants often have a disproportionate use of water, trash, electricity and security services, the parties need to address whether the tenant should pay only its proportionate share of CAM for those items based on square footage, or whether such a calculation will result in non-restaurant retail tenants subsidizing restaurant uses.

Landlords may seek percentage rent to capture a portion of their tenants' gross sales over a certain breakpoint, and restaurant tenants will want to agree upon specific calculations and exclusions from gross sales. Landlords often want to include gift card sales in the gross sales calculation at the time the gift card is sold, but tenants (especially with chain restaurants that sell gift cards that can be redeemed in any number of locations) usually require that they not be included in gross sales until the gift cards are redeemed. Landlords and tenants usually find common ground in excluding from the gross sales calculation the cost of employee meals, gratuities, house allowances, insurance, condemnation and refinancing proceeds, and the sale of FFE.

EASEMENTS AND LICENSES • As referenced above, tenants need to verify the existence of easements on the lease property necessary for additional parking or valet parking services, signage, access, and utilities. If the necessary easements do not exist, landlords should grant tenants the appropriate licenses for the term of the lease. This may require giving the tenant and its contractors access to roofs, interior chases, grease traps, and more. The lease may also need to grant licenses for valet stands non-exclusive patio seating within common areas or drive-through lanes with the landlord having a recapture right.

RELOCATION • If a landlord wants a tenant to relocate, the cost should generally come out of the landlord's pocketbook, and the tenant should have the right to terminate the lease if the replacement space is not satisfactory to the tenant. A tenant moving at a landlord's request should demand compensation for all losses including reasonable lost profits, the cost of obtaining new liquor and other licenses covering the new space, and the dark period costs accrued to their staff. A landlord has incentive to both cover the cost and retain the right to relocate a tenant, as it prevents a tenant from ransoming a spot a landlord seeks to offer to another business, and facilitates the growth of the development.

DELIVERY CONDITIONS BY PREMISES TYPE • Parcel type can determine certain aspects of a lease, including necessary due diligence, easements, and maintenance. Outparcel or pad sites will require an ALTA survey, Phase I Environmental Report and geotechnical soil tests, while in-line sites need a landlord to provide drawings of mechanical, electrical, and plumbing plans.

Conditions for delivery also vary by site type. Landlords must bring utilities to an in-line restaurant. In-line leases should contemplate a clear allocation of shared line costs (separate meters or combined). Parties will want to define whether a site comes build-to-suit or as a shell for the tenant's improvements, and who is to install and maintain grease traps, dumpsters, and adequate venting. On the other hand, landlords of restaurant pad sites have the option of delegating to tenants the responsibility to bring utilities to the site in required capacity and even constructing a parking lot. Remedies for non-performance of pad site delivery conditions are more likely to include self-help, whereas remedies in the in-line context are more frequently limited to liquidated damages or termination with a reimbursement of costs. To ensure that both parties perform as expected, it useful to include good faith obligation for delivery and realistic time frames for each party's completion of work.

PROTECTION FROM INTERFERENCE •Tenants will want to protect their restaurant area from interference that may deter guests or the frequent deliveries. A lease can achieve this by limiting the placement of certain businesses within a specified distance from the premises, prohibiting temporary events such as fairs and carnivals, and restricting obstructions such as scaffolding, prolonged parking lot maintenance, closure of drive aisles and access routes. Landlords desire flexibility in the management of their properties, and will prefer to limit the restrictions allowed, especially considering they must balance those limitations with other tenants' needs. Agreeing to allow only certain designated uses for nearby tenants, or establishing areas as permanent parking, access, or landscaping areas can mitigate disputes over temporary interference or permanent changes. This can be done on a site plan attached to the lease, assuring clarity in what will remain protected and what is subject to change. Another common sense approach for temporary interference is to require prior notice to and coordination with the tenant and an obligation to use reasonable efforts to minimize the impact to the restaurant's operations (such as avoiding parking lot maintenance projects on holidays or performing roof work outside of the tenant's hours of operation).

GUARANTEES • Restaurant tenants are uncertain business ventures. Often restaurateurs will attempt to insulate themselves from personal liability by creating special purpose entities (SPEs) to operate the restaurants and serve as the named tenant entities. Because an SPE tenant may not be adequately capitalized to provide sufficient financial resources in the event of a breach of a lease, landlords need to consider conditioning the lease upon obtaining personal or corporate guarantees from third parties with adequate financial resources to cover tenant's obligations in the event of default. Obviously, tenants are hesitant to place their personal financial resources at risk. Landlords and tenants need to give due consideration to the concerns of each of the parties and strike a fair balance that protects the respective parties' interests. Often this can be achieved by requiring guarantees limited to a specific number of years of the lease term to ensure that the tenant is viable and proven to meet its obligations under the lease.

CONCLUSION • The restaurant business is notoriously risky and challenging, but also exciting for restaurateurs and often a vibrant addition to a landlord's development. Tenants and landlords can ease potentially complicated situations that arise in the formation and performance of a restaurant lease by anticipating and negotiating key provisions and assigning responsibilities explicitly and specifically in a lease as set forth above.