RESTAURANT LEASING: PERMITTED USE AND EXCLUSIVES

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PERMITTED USE

The use of a premises is often a tug-a-war between landlord and tenant. Landlords favor narrow use provisions in order to protect their ability to maintain a mix of tenants in their development, including the types of restaurants operating in the project. 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). The use clause is important to a landlord as it is a means of ensuring that it gets the use it expects, not just upon the opening of the restaurant but for the duration of the lease. Landlords may also want to control the types of restaurants located at their venues. For instance, a landlord's vision of its venue may include all higher price point restaurants to complement a higher price point retail area or it may involve a diverse mix of fast casual restaurants with little or no duplicative uses.

In an ideal situation, landlords would like to see a use clause in the lease which limits the trade name of the tenant and food offerings. In addition, landlords prefer to attach a menu as an exhibit to a lease to establish the parameters of a potential tenant's use. Here is an example:

> Tenant shall operate the Premises under the trade name "[Trade Name]" and shall use the Premises solely for the purpose of conducting the business of a [Theme]-themed restaurant offering for sale only those items listed on Exhibit attached hereto and made a part hereof, and for no other purpose whatsoever.

On the other hand, 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." Tenants will want as much freedom as possible in order to change both its menu and trade name, as well as change the restaurant concept, as customer trends and tastes evolve over time. However, tenants should understand that certain conceptual parameters will need to be established to make their landlords comfortable with these provisions.

In addition, some restaurant tenants may want to include a small retail component to their offerings. Obviously, landlords want to make sure the location remains primarily a restaurant and not become a retail or hybrid concept. 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 the life of the lease.

A more elastic use clause can accommodate some of the tenant's needs to change over the term of the lease while addressing the concerns of the landlord. 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 between limiting the use clause and allowing a business to adapt and succeed.

The clause below not only attempts to strike the needed balance, it also provides a starting point for the overall discussion of what concept will be presented at the location. Here is an example:

> Tenant shall operate the Premises under the trade name "[Trade Name]" and shall use the Premises solely for the purpose of conducting the business of a [Theme]-themed restaurant offering for sale only those food and beverage items contained in the menu attached hereto and made a part hereof as Exhibit ___, provided that Tenant may change individual food and beverage items on such menu without Landlord's consent if the menu, as changed: (A) contains the same food and beverage items sold by all, or substantially all, other "[Trade Name]" locations in the [Geographical Area], and (B) is consistent with a [Theme]-themed restaurant, and Tenant may also sell at retail, as an incidental use, "[Trade Name]" labeled promotional items (such as hats, t-shirts, and gift cards), provided however, that the portion of the Premises used for the sale of such incidental items shall not be greater than [Size] square feet in the aggregate, and for no other purpose whatsoever.

EXCLUSIVES, PROHIBITED USES AND USE RESTRICTIONS

Similar tensions exist with respect to exclusivity. Restaurant tenants 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 ability to use the remainder of its 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 on 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 a landlord the flexibility to lease the rest of its property and be enforceable, yet broad enough to protect a 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. 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 percent) 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 the problems 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:

1. Does the exclusive remain in effect in the event of an assignment or sublease;
2. Does the exclusive remain in effect if tenant ceases to operate;
3. Does the exclusive remain in effect during any extension periods;
4. What should be the remedies for a breach by landlord and should they depend on whether or not the breach was intentional; and
5. 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).

While exclusive use provisions protect a restaurant's business, they open the door for landlord liability. Landlords often worry about anti-trust claims and seek to pass the risk of such a claim to the tenant

by requiring that either tenant forego the exclusive or indemnify landlord for any anti-trust 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.

In an effort to balance the needs and wants of both parties, the below exclusive provision provides the tenant with a protection from competitors, but also enables the landlord to develop and remix its venue. Here is an example:

> (a) Notwithstanding anything contained in this Lease to the contrary, but subject to this Section _____, provided (i) this Lease is in full force and effect, (ii) Tenant is not then in breach of any of the terms, covenants or conditions of this Lease required to be observed or performed by Tenant, and (iii) Tenant is open and operating in the Premises in accordance with the terms of this Lease, if after the date of this Lease, Landlord enters into a lease with a Competing Tenant (as hereinafter defined) and the Competing Tenant thereafter operates its premises within the Shopping Center primarily as a Competing Use (as hereinafter defined) for a period of ( ) days following Tenant's notice thereof to Landlord (the "Competing Use Cure Period"), then [Insert remedy here] for so long as the Competing Tenant continues to operates its premises primarily as a Competing Use. The benefits of this Section __ are personal to the named Tenant under this Lease. In the event of any assignment of the Lease by Tenant or sublease of all or any part of the Premises by Tenant, this Section __ shall be null and void and of no further force or effect. The foregoing sentence is not intended to, and does not, create any right of assignment or sublease by Tenant.
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> (b) In the event Tenant is entitled to [Remedy for Exclusive Violation] for _____ (__) consecutive months, then at any time thereafter, Landlord may, at its sole discretion, terminate the Lease upon not less than _____ ( ) days' notice to Tenant. This Lease shall terminate at the end of said notice period without any additional action or notice by Landlord and Tenant shall have no further right, title or interest in or to the Premises, unless Tenant gives Landlord notice within ten (10) days of Landlord delivering said termination notice to Tenant that Tenant irrevocably and unconditionally agrees to [Undo whatever Remedy Existed].
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> (i) The term "Competing Use" shall mean: [DEFINE RESTRICTED/EXCLUSIVE USE SCOPE].
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> (ii) The term "Competing Tenant" shall mean any individual or entity that is not:
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> (1) Tenant or a related entity, (2) a licensee, concessionaire, franchisee, assignee or sublessee of Tenant or any related entity, (3) any individual or entity occupying a premises in the Shopping Center which is equal to or [greater than/less than] _____ square feet, (4) an individual or entity operating in the Shopping Center pursuant to an order or other action of a bankruptcy court or other similar judicial proceeding, or (5) a tenant or occupant of the Shopping Center operating in the Shopping Center pursuant to a renewal, modification, assignment or sublet of any lease or other agreement

entered into with such tenant or occupant prior to the date of this Lease (including, but not limited to, any renewals or modifications of such lease or other agreement which relocates, expands or otherwise reconfigures the premises which such tenant or occupant occupies) for so long as such lease or other agreement (or renewal thereof) remains in effect.

(d) Notwithstanding anything to the contrary contained in this Section , the following shall not be deemed Competing Uses:

(i) The operation of a theme restaurant, such as a sports or music-themed bar;

(ii) The primary use of the service of food and beverages, and incidental to such use, the performance of live or recorded music;

(iii) The operation of a restaurant that specializes in a single ethnic cuisine, such as Japanese, Chinese, Italian, French, German, Mexican, Spanish, Cuban, or Portuguese;

(iv) The operation of a restaurant that specialized in a single regional cuisine, such as Middle Eastern or Asian;

(v) The operation of a restaurant commonly known, as of the date of this Lease, as [List examples of restaurants], or similar type(s) restaurants; or

(vi) Any tenant or occupant whose premises is wholly or partially located in a "food court area" of the Shopping Center.

(e) Notwithstanding anything to the contrary contained in this Section ___, if a Competing Use is the result of the unauthorized actions of a tenant or occupant of the Shopping Center (e.g. operation of a Competing Use by a tenant or occupant of the Shopping Center without the consent of Landlord and/or in contravention of the terms and conditions of such tenant or occupant's permitted use pursuant to its lease or other applicable agreement), and Landlord commences and diligently pursues commercially reasonable efforts to cause such Competing Use to cease, then Tenant's right to the remedy available to Tenant pursuant to this Section ____ shall not be deemed to commence until the later of (i) the first day of the calendar month immediately following the end of the Competing Use Cure Period, and (ii) the first date upon which Landlord fails to expend such reasonable efforts and/or exhausts all available remedies of which Landlord may be entitled to seek to cause such Competing Use to cease.

CONCLUSION

While there is often a tug-a-war between landlord and tenant both with respect to a tenant's permitted use and any exclusive rights a tenant may be granted, if both parties want to consummate a transaction, there is a way to reach an agreement. In doing so, however, both parties need to carefully draft the relevant clauses so that during the lease term each party has the protections they thought they had.