

Greatest All Time Rivalries: Landlord vs. Tenant - Tips to Make Peace and Prosper

Head Coaches: Kyle Kavanaugh, President, Main + Main, Inc.
Steve Rich, Vice President, Restaurant Leasing, Simon Properties.

Special Teams: Larry Summerton, Director of Real Estate, Brio Bravo Restaurant Group;
Carlos Bernal, CEO, Pitfire Pizza Company;
John Benazzi, Attorney (Real Estate/Leasing), Davis Wright Tremaine LLP

With the transition away from brick and mortar retail stores, restaurants are becoming the new shopping center “junior anchor” retailers. As much as (or more than) specialty retailers, restaurants build the identity of a center, attracting customers and keeping them there longer. National retailers are increasingly demanding restaurants as co-tenants and even seeking co-tenancy protection based on the number—or type—of restaurants operating. Understanding each other’s desire for security and flexibility (and knowing their pressure points) on certain hot button issues can mean a more efficient and productive lease negotiation process.

1. EXCLUSIVE USE PROVISIONS:

- a. What is the legal effect of an exclusive? Landlord and Tenant should agree on who will bear the burden of enforcing those rights and what remedies Tenant may have if either another tenant encroaches or Landlord fails to include the applicable restriction in future leases.
- b. Tenant wants PROTECTION, ENFORCEMENT and REMEDIES because a shopping center may but not be able to support two similar concepts. Tenant will want it to be Landlord’s responsibility to enforce the exclusive against rogue tenants. Tenant’s remedies for breach of the exclusive can include consequential damages, injunctive relief, termination rights (with repayment of unamortized tenant improvement allowance), abated rent or reduced rent (percentage of gross sales).
- c. Landlord wants to DELEGATE and CARVEOUT. Landlord would rather not be responsible for enforcement, but rather delegate or assign its right of enforcement to Tenant to go against the rogue tenant. Landlord wants the exclusive to be as limited and narrow as possible--only for “primary use”; should not apply to existing tenants or to tenants of more than x number of square feet or to “full service”, sit down restaurants; should only apply to a limited “protected area” within the center. Landlord also wants to limit Tenant’s remedies as much as possible--no termination right (could impact the financeability of the center); Tenant’s rent abatement right limited to x months of abated rent, then Tenant either has to terminate or resume full rent payments.

2. ASSIGNMENTS/SUBLETTING/EXIT STRATEGIES

- a. What should Tenant insist on in order to maintain flexibility? What should Landlord insist on in order to protect its investment?
- b. Tenant enters into long-term restaurant leases in order to recoup their investments in a selected site. Tenant may need the ability to assign/sublet the space in order to SELL the business, solicit new INVESTMENT in the business, or maintain an EXIT strategy for a poorly performing site. To do this, Tenant should insist on the ability to assign the lease on sale/merger/changes of control and to affiliates (and/or franchisees). For such “permitted transfers” Landlord should only have prior notice requirement. For third party transfers, Landlord’s approval right should be “reasonable” (not in its sole discretion).

- c. Landlord requires PROTECTION of its investment in the center—after all, the economic terms of the Lease may have been predicated on the name and net worth of Tenant. Landlord may insist on minimum net worth requirements, minimum number of locations in order to qualify for a “permitted transfer”, change in use restrictions (a new tenant may not violate existing exclusives, etc.)

3. LIQUOR LICENSE CONTINGENCIES.

- a. The ability to obtain a liquor license can be a “make or break” issue for Tenant. The availability of a liquor license should be ascertained during site selection, prior to negotiating the Lease.
- b. Tenant may also want to negotiate a CONTINGENCY including a right to terminate if it is unable to obtain the required permits by a date certain. Tenant might also negotiate a rent commencement date that is tied only to receipt of permits. Tenant should also be careful to review any REAs encumbering the center for alcohol restrictions
- c. Landlord obviously wants to limit any open ended contingency. If Tenant has a termination right, it should be exercised by a date certain or it should be waived. If Tenant’s rent commencement date is tied to permits, then Landlord should insist that application be made by a date certain and potentially negotiate a drop dead date by which Tenant must begin paying rent.

4. MIXED USE PROJECT ISSUES.

- a. Restaurants create NOISE and ODOR.
- b. Landlord wants to protect its other tenants (and the public) against nuisance, objectionable odor and noise. Landlord may add clauses requiring specific venting/air circulation systems.
- c. Tenant should be careful to exclude “normal odors associated with the preparation of food and the operation of a restaurant” and no “unreasonable” noise. As part of due diligence, Tenant should make sure that venting is possible/practical.

5. INTERRUPTION/RELOCATION CLAUSES

- a. As the economy changes, more and more centers may need to be repositioned. This may require that Landlord renovate and or relocate tenants within a center. Why does Landlord insist on such rights and what can Tenant do to protect itself against unreasonable interference with its business?
- b. Landlord requires FLEXIBILITY to make changes to the common area, renovate the center, and even move tenants to accommodate new anchor tenants, etc. Tenant should insist that any changes to the common area do not adversely affect ACCESS, VISIBILITY or PARKING in the vicinity of the Premises.
- c. With respect to RELOCATION rights, Tenant should insist on EQUIVALENT SPACE (in terms of square footage, street frontage, parking, “protected area”); Tenant should insist that Landlord build out the space at Landlord’s expense (or reimburse Tenant for its build), Landlord should pay for all moving costs and incidentals; Tenant also wants to limit its down-time by requiring a “hot start” (i.e., that Landlord cannot insist on a move that would result in Tenant being dark for more than x number of days), Tenant may also insist on payment of lost profits for any down time.

6. KICK OUT CLAUSES/PERFORMANCE OPTIONS

- a. What is the legal effect of a kick out? A kick-out clause gives Tenant (or Landlord) the right to terminate the lease at a fixed time in the lease term if certain conditions, typically sales benchmarks, are not met.
- b. In uncertain economic times or for transitioning centers, Tenant may insist on a TERMINATION right if it does not meet the sales benchmarks it sets for itself. After all, at a certain point it makes little sense to continue losing money at a losing location. If Tenant is unable to negotiate a kick out, it may consider “go dark” rights as an alternative—this would allow Tenant to close its doors (but continue paying rent) while presumably both parties seek a replacement option.
- c. In either case (kick outs or go darks), Landlord would want advance NOTICE of termination (*x* months), penalty or termination FEES (equal to unamortized lease concessions or a certain number of monthly rent payments). Landlord may also insist on its own RECIPROCAL kick-out clause allowing it to terminate the lease if Tenant’s sales benchmarks are not met. This might make sense where the parties are banking on Tenant paying some percentage rent to make up for lower base rent or high tenant allowances.
- d. PERFORMANCE OPTIONS: Landlord might also insist on extension options where Tenant’s right to extend the term is tied to it meeting a certain sales benchmark (again this is typically tied to payment of percentage rent).

7. CONTINUOUS OPERATIONS, OPERATING HOUR REQUIREMENTS, RECAPTURE

- a. What is the legal effect of a continuous operating provision? Operating covenants require a tenant remain open during certain hours and certain days. A landlord’s remedies for default may include imposition of penalties and even the declaring a tenant in default under the lease.
- b. Landlord wants MINIMUM OPERATING HOURS and PENALTIES for failure to open. Vacancies in a center create image problems, co-tenancy problems and percentage rent problems for Landlord. In a percentage rent deal, Landlord wants Tenant to do everything it can to maximize gross sales (although in a properly incentivized deal it is generally unlikely that a Tenant will go dark if it is paying percentage rent). If Landlord agrees to a “go dark” provision then it wants RECAPTURE rights (repayment of unamortized Tenant Improvements and/or Allowances)
- c. Tenant wants FLEXIBILITY. If Tenant agrees to a continuous operating provision, it needs carve-outs for force majeure, remodeling, holidays. It might also consider flexibility for menu redesign, limiting breakfasts or dinners, etc. Tenant will also strongly contest the imposition of “penalty rent” for failure to open. Landlord’s only remedy should be to terminate the Lease—choose to continue collecting rent or terminate the Lease.