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Workshop 21

Restaurant Leasing: *Oops!* Don't Overlook These Important Ingredients When Cooking Up a Restaurant Lease

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VIII. SUMMARY

I. DUE DILIGENCE AND RESTRICTIONS

Restaurant Restrictions. While this may seem obvious, the first item to confirm when entering into a restaurant lease is that your restaurant is a permitted use. Just because retail use is legally permitted, you need to check if restaurant use is specifically permitted. Zoning is not typically a problem, as most commercial zoning classifications permit retail and restaurant use. The bigger issues typically arise from private restrictions set forth in recorded declarations or other tenant leases. It is important on both ground leases and space leases to review title and confirm that there are no restrictions that would prohibit your restaurant operation. Many tenants do not spend the money to order and review title for a space lease, and if that is your client's decision, then you need to include representations and warranties from the landlord that your restaurant use is permitted. One of the things to look out for is a restriction on the aggregate number of restaurants in a center or on the aggregate square footage of restaurants in the center. If you enter into a lease where the center is subject to one of these restrictions, you need to include a provision in your lease that you are 1 of the allocated aggregate number of restaurants or that you are "x" square feet of the total permitted square footage of restaurants.

Drive-Thru Restrictions. While a restaurant may be permitted, a restaurant with a drive-thru may be prohibited either due to the local jurisdiction, a recorded title matter or another tenant's lease. When a drive-thru is permitted, it must meet the applicable stacking requirements of the governing jurisdiction and, in some cases, title matters that will vary on the required stacking spaces needed for each menu board and service window. There also needs to be sufficient ingress and egress to and from the drive-thru lanes and an escape lane. Also, if off-site improvements are required by the jurisdiction, such as a traffic light that allows turns into the drive-thru, the lease needs to allocate the responsibility for this improvement and who bears the risk if it is not obtained timely or, if obtained, later removed or relocated due to condemnation or other traffic concerns.

Alcohol Restrictions. If the sale of alcohol is a critical part of the tenant's restaurant business, you need to confirm that there are no restrictions that prohibit the sale of alcohol or prohibit the sale of alcohol above a certain amount, typically expressed as a percentage of gross sales. Keep in mind that depending on the restaurant concept and its physical location, gross sales from alcohol can vary considerably. If the restaurant is planning on serving alcohol on an outdoor patio, depending on jurisdiction, you may need to build certain type of enclosures around the patio to separate it from the general public. As part of the lease negotiations, in a space lease, it is important to confirm who is responsible for installing any railing, and to the extent the tenant is required to install the railing, the tenant should reserve the right to do so in the lease.

II. USE CLAUSES AND EXCLUSIVE USE PROTECTIONS

Use Clause Concerns. Restaurant tenants request flexibly to change their use without landlord's consent, and landlords desire to restrict the tenant's use to the initial use or any other use approved by landlord. This is not necessarily unique to restaurant leasing, but restaurants do present some different issues from general retail uses.

From the tenant's perspective, if the original concept is not successful at a particular location, the tenant may want to change the use (if the tenant operates multiple concepts), or more likely, the tenant wants flexibility to assign the lease or sublet the premises to a different restaurant operator without the need to obtain approval from the landlord for a change in use**.** For the tenant, ideally, the landlord will agree to allow any lawful retail or restaurant use. However, most landlords when negotiating a restaurant lease, at least want to ensure that the space will be used for a restaurant. In that instance, the tenant wants a broad use clause that permits any restaurant use that does not violate any exclusive in effect as of the date of the lease. Of course, from there the negotiation goes to "fine dining restaurant," "sit down dining restaurant" and so on. Once the use is agreed upon, it is critical for the tenant not to agree to the tradename of the restaurant as part of its permitted use clause. Additionally, from the tenant's view, you should avoid attaching a menu as an exhibit. If the landlord insists on referencing a menu to further define tenant's permitted use, make sure to clarify that the tenant has the right to change menu items after it initially opens for business under the initial trade name, at least in connection with menu changes typically done by such tenant or otherwise reasonably consistent with the tenant's permitted use.

From the landlord's perspective, landlords want to restrict a tenant's ability to change the use of a retail space for a variety of valid reasons. Landlords often have specific plans for the overall composition of a commercial property. Allowing tenants to freely change the use of their space could disrupt these plans, potentially affecting the attractiveness and value of the property. In addition, different types of businesses have different operational needs

and customer traffic patterns. With respect to restaurant uses specifically, if a landlord leases space to a high-end white table cloth restaurant, the landlord understandably wants to maintain that class of operator and does not want the tenant to have the unrestricted right to change its use to a casual dining restaurant. In addition, the landlord may have co-tenancy obligations that require a white table cloth restaurant, which prevents the landlord from agreeing to allow the tenant to unilaterally change its use. On the flip side, if landlord leases to a counter-service restaurant, the landlord may not be able to permit the tenant to change its use to a full-service sit-down dining restaurant due to parking requirements. Overall, restricting a tenant's ability to change its use helps landlords maintain control over their property, preserve its value, and ensure the appropriate tenant mix.

Exclusive Use Protections. Exclusive use provisions in restaurant leases can have some unique considerations compared to those in general retail leases. Restaurant exclusives often focus on the type of restaurant, the type of cuisine, and sometimes even hours of operation.

With respect to the type of restaurant, the tenant should seek an exclusive that is as broad as possible such as:

> "No portion of the Center (except for the Premises) shall be used as *a restaurant* with a menu featuring Italian-themed food items."

In response to the foregoing, a landlord should narrow and clarify if it only applies to a type and/or class of restaurant being operated by the Italian restaurant, such as only a full-service restaurant where there is waiter/waitress service, orders are placed from white tablecloth tables, versus fast casual or quick service restaurants limited to counter service:

> "No portion of the Center (except for the Premises) shall be used as a *full-service sit down dining restaurant* with a menu featuring Italian-themed food items. Notwithstanding anything in this Section to the contrary, the foregoing exclusive use restriction shall not be applicable to any pizza restaurant (i.e., the sales revenues from pizzas, flatbreads and calzones represent (or will represent) seventy percent (70%) or more of the total food sales revenues at the subject restaurant)."

Of course, the type of cuisine is the next negotiated point. For instance, is the exclusive broad (such as a certain coffee shop that we all know and love) which limits not only coffee, but also prohibits tea, blended beverages, and beverages served with ice. From a landlord perspective, it is imperative you try to limit these broad exclusives to the tenants main revenue sources and eliminate items that prohibit every other restaurant (such as those that serve beverages with ice). Additionally, some tenants have a laundry list of food items which comprise their exclusive and the sale of such items, individually or in the aggregate, above a certain threshold (whether measured by gross sales or menu items) is a violation of their exclusive. In the instance where there is a list of food items that make up the tenant exclusive use, the tenant needs to ensure that the exclusive stays in the event the tenant ceases to sell one of the food items that makes up its exclusive, but continues to sell the remainder (i.e., if the tenant has an exclusive over the sale of chicken and custard and later change its business model to chicken and frozen yogurt, the tenant needs to ensure that the exclusive is written in such a manner that the sale of chicken is still protected).

When negotiating how to define "featuring" or "primarily selling" a certain type of food, obviously the tenant desires for the percentage to be lower and the landlord desires for it to be higher. The more interesting issue with restaurants is that, often the "feature" or "primarily selling" description will be a percentage of menu items, where general retail typically defines "featuring" or "primarily selling" as a percentage of gross sales or sales floor area devoted to the display of such items. In restaurant leasing, using a percentage of menu items can be good (potentially for both parties), as it is an easy standard to confirm simply by looking at the menu of another tenant, whereas evaluating the gross sales of another tenant (or, from a landlord perspective, anticipating what those gross sales may be year over year) is very difficult to confirm. With respect to using a percentage of menu items as the threshold, if you are the tenant, you do not want your percentage of menu items to be watered down by including side items and beverages. As such, you should always tie the percentage to appetizers and entrees or, depending on the type of restaurant, potentially entrees only, and specifically include specials:

> "Featuring' means that Italian-themed food items constitute (or will constitute) twenty percent (20%) or more of the total number of appetizers and entrees listed on the menu (including any limited time offers and/or so called "specials") at the subject restaurant."

Finally, some restaurant tenants, such as restaurants who only serve breakfast, brunch and lunch, include hours of operation in order to further define "featuring" or "primarily selling". For instance, a breakfast tenant may define

primarily selling breakfast and/or brunch items to as an occupant deriving greater than twenty percent (20%) of its gross sales from the sale of breakfast and/or brunch hours *during Tenant's hours of operation on any given day*. This would eliminate the landlord's ability to lease space in its project to a full-service restaurant selling lunch and dinner who wants to offer brunch on the weekend. As such, the landlord should attempt to either expand on the "any given day" language or to obtain a carveout for a full-service restaurant offering brunch.

III LANDLORD'S AND TENANT'S WORK

Scope and Work Letter. Both landlord and tenant need to agree upon a work letter that should be an exhibit to the lease and address if utilities need to be installed or upgraded for water, water pressure, electricity, gas, sewer, grease trap and the locations to which they will be brought, such as a construction limit line for a ground lease or a point of connection for buildings if the tenant is not constructing the building. The work letter needs to address capacities for the utilities, allocation of responsibility, deadlines for completion, phases, if applicable, and remedies if incomplete work or work not yet inspected and approved by the applicable jurisdiction, prevents the other party from completing its work. Ideally, the work letter is specifically negotiated and agreed upon as part of the LOI. While work letter issues in general are not specific only to restaurant leases, there are several restaurant specific items to which you should pay close attention.

- **Pollution Control Units** (also known as "scrubbers" or "PCU") – The purpose of a PCU is to mitigate the environmental impact of restaurant operations, particularly the emissions of grease, smoke, and odors. In some cases, there may be local, state, or federal regulations mandating pollution control measures for commercial properties like restaurants. In this event, the landlord needs to ensure its property complies with these regulations to avoid fines or legal issues. If a PCU is required by law, the tenant should try and require the landlord to install and maintain the PCU, at landlord's sole cost. In most cases, however, landlords want to require a PCU for restaurant uses to ensure that the other occupants of the project are not disturbed by smoke and odors emitted from the restaurant. This occurs most often in high rise office, hotel or residential buildings. Restaurant tenants, on the other hand, resist installing pollution control units for various reasons. While a PCU adds an additional construction cost, they are also very expensive to maintain. In addition, a PCU requires space for installation, which can be limited in a restaurant setting where every square foot counts. The tenant may be reluctant to sacrifice valuable kitchen or dining space for equipment that it perceives as unnecessary. From the tenant's perspective, the initial position should be that tenant is not obligated to install a PCU in any event (and this often is stated in the general provision where landlords prohibit noxious odors and fumes). If, however, the PCU is required by law or due to the nature of the project, the parties need to allocate the responsibility for installation and ongoing maintenance during the term.

- **Impact Fees.** Impact fees are often a bigger issue for a restaurant user than general retail. As a condition to getting a building permit, the applicable jurisdiction will assess fees for utility upgrades, particularly for sewer and water which restaurants heavily use. These may be called tap in fees, impact fees, or high usage fees and can be substantial sums. In the LOI and Work Letter, the parties should expressly allocate who pays for these fees, regardless if such fees are assessed in connection with approvals for landlord's work or tenant's work. Ideally, the tenant wants the landlord to pay the impact fees, particularly because the landlord desires for (and as set forth above, often requires) the tenant to operate as a restaurant. While this is a negotiated point, if your deal is an "as-is" deal, the restaurant tenant is much less likely to get the landlord to agree to pay for the impact fees. As such, it's critical from a business perspective to ensure that your restaurant client obtains a site investigation report or otherwise confirms the amount of the impact fees that will be assessed in connection with its development and use of the property, and further includes such amount in its pro forma. From a lease perspective, if the restaurant tenant is redeveloping existing space in the project, be sure to include the tenant's right to use any available credits, as follows:

  > "Tenant shall pay as and when due any and all impact fees and other infrastructure/capacity-related charges or fees based, wholly or in part, upon the proposed redevelopment of the Premises, and, in connection therewith, Tenant shall be entitled to receive the benefit of any and all available credits related to the prior development, use and/or occupancy of the Premises."

- **Grease Interceptor.** Most restaurants require the use of a grease interceptor in order to capture and separate fats from wastewater prior to the wastewater's entry into the sanitary sewer system to prevent

blockages downstream. The grease interceptor requires routine pumping to remove the separated grease and fat from the grease interceptor, which is discussed in more detail below. If the restaurant is first generation space and there is no existing grease interceptor, the work letter must allocate the responsibility to install the grease interceptor to either the landlord or the tenant. The work letter should contain the tenant's specifications with respect to the capacity (i.e., 1,500-gallon grease interceptor), but some jurisdictions may require a greater capacity than the tenant's standard. Therefore, whether the tenant or the landlord is installing the grease interceptor, the requirement should always be the tenant's normal capacity *or such greater capacity as may be required by code*. If the grease interceptor is going to be shared with other tenants, then in most instances the landlord will be required to install a common grease interceptor.

- **Electric Transformer.** While every type of use requires power, a restaurant relies heavily on electrical power for the use of its kitchen equipment, refrigeration, and HVAC systems. A restaurant user often desires for the landlord to provide an electric transformer for tenant's *sole and exclusive use*. Having an electric transformer dedicated exclusively to the restaurant ensures that it can meet its electrical needs without overloading a shared electrical system, which could lead to power outages or disruptions. Depending on the jurisdiction, transformers can be very expensive, so the landlord will often prefer to provide a shared transformer. As such, the work letter needs to specifically state whether the transformer is for the tenant's exclusive use or if it is permitted to be shared with other tenants.

- **HVAC.** While every tenant requires HVAC, HVAC requirements for restaurant users are typically greater due to the heat generated by cooking as well as the number of patrons in the space at any one time. The work letter should specifically provide who supplies the HVAC (including the units and distribution throughout the space) and the required specifications (i.e., tonnage). While HVAC is typically straightforward, it can become very complicated in buildings where the HVAC is provided by a condensed or chilled water system. This is most often found in high-rise office, hotel or apartment buildings. Determining the required capacity often involves detailed engineering and may not be discernable at the lease negotiation stage. This may be further complicated by intended tenant improvements. For instance, consider an office building that has a condensed water system, which is designed to heat and cool a 10,000 square foot restaurant space on the ground floor, but the restaurant tenant desires to construct a mezzanine space for additional dining, which now increases the occupied square footage above the 10,000 square feet of space that the building's condensed water system was designed to serve. In this instance, it is imperative at the lease negotiation stage that the parties determine how the additional capacity will be obtained and who is obligated to pay to install any additional required equipment. In connection with condensed or chilled water systems, the tenant should also require that the level of demand (i.e., temperature coming in and out) be provided 24 hours a day, 7 days a week, 365 days a year. Finally, there are additional charges associated with condensed and chilled water systems. The lease needs to provide if the landlord intends to charge the tenant for such usage, and if so, the tenant wants to impose similar constraints on such charges as it does for common area maintenance costs (i.e., caps and audit rights).

IV. OPERATIONAL ISSUES

Trash Removal. Leases need to be very clear as to whether landlord or tenant is providing the trash removal service for the premises and how its billed (i.e., included in CAM, or a separate trash charge, billed directly to tenant etc. based on usage, pro rata share of use, sf etc.). The lease needs to address (i) if trash enclosures are required (and if so, which party is building it), (ii) where the trash containers will be located, including the path of travel from the restaurant to the trash enclosures, and (iii) if a refrigerated trash room inside the restaurant is required.

If the landlord provides the trash service in the center, the landlord will want to impose a requirement on the tenant to use the same service provider. This may be problematic for certain tenants who have national accounts with waste removal service providers. If a landlord wants the right to change who handles trash on notice to the tenant, the tenant should require that the landlord reimburse the tenant for its termination fees if it has to terminate its trash vendor agreement early in order to switch to the landlord's trash vendor. If landlord is providing the trash removal, a restaurant tenant needs to ensure that the landlord is providing adequate size and number of trash dumpsters for both trash and recycling and that it will be removed often enough to avoid overflow. A restaurant will insert a Landlord acknowledgment such as:

> Landlord hereby acknowledges and agrees that Tenant requires a minimum of one (1) 6-yard trash container and one (1) 4-yard recycling container to accommodate Tenant's refuse. Landlord shall

cause the dumpster(s) serving Tenant to be emptied as often as necessary to accommodate the number of occupants using such dumpster(s) to ensure there is sufficient capacity at all times.

Grease, Fats, Oils and Odors.

- **Grease Interceptors.** As set forth above, the lease must be clear on which party installs the grease interceptor and whether it is shared or for tenant's exclusive use, but the lease also must clearly provide for who is obligated to clean, maintain and repair the grease interceptor during the term. If tenant is maintaining the grease trap, it will want to resist the landlord dictating how often the grease trap is cleaned (bi-weekly, monthly or quarterly) and instead should try to limit the requirement to "as often as reasonably necessary," "in good condition and repair," or "in accordance with tenant's typical schedule used in a majority of tenant's other restaurants." If the grease interceptor is shared with other occupants, then landlord will most perform all maintenance. As such, the lease needs to be clear whether the routine pumping of the grease interceptor is included in CAM (particularly if tenant has negotiated a fixed CAM fee and/or caps) or whether there is a separate charge imposed by the landlord for pumping the grease interceptor. If the landlord is performing the maintenance of the shared grease interceptors and charging its costs to its occupants as part of CAM, the landlord will want the ability to establish separate CAM pools so only restaurant tenants who utilize them pay toward the cost of maintaining them.

- **Grease Barrels.** There are companies, such as Restaurant Technologies, that recycle used cooking oil and grease collected by restaurants. Recycled grease and oil may be used to create biodiesel (a renewable fuel source), animal additives, soaps, detergents and cleaning products, and (everyone's favorite to think about) cosmetics and skincare products! As such, these companies will often pay restaurants to collect the used cooking oil and grease that they collect. Therefore, restaurant tenants will also want the lease to permit the tenant to have a waste oil tank or an animal grease barrel in the premises and/or an outdoor fill box for used cooking oil and grill grease. If the tenant needs an area to place these tanks or barrels outside of the premises, the lease needs to specifically allow for this right (often in the trash enclosure), and the landlord should require the tenant to ensure that such area remains clean and that the tenant cleans any grease and oil spilled while transporting the grease and oil from the premises.

- **Odors.** Landlords typically provide for a general prohibition against noxious odors and fumes, so a restaurant tenant should add an exception to the general prohibition that "odors and fumes typically associated with tenant's restaurant use (or a first-class restaurant use) will not violate the lease or be deemed noxious odors or fumes or a nuisance." As noted above, the tenant may want to provide in this provision an express acknowledgment that tenant is not required to install a PCU to control odors or fumes. If the landlord insists on imposing additional requirements related to exhaust and odors, the tenant should attempt to cause the landlord to agree that so long as tenant installs the exhaust equipment shown the plans approved by landlord, and thereafter maintains same in accordance with the manufacturer's requirements, the tenant shall not be obligated to install any additional equipment to control the emission of odors or fumes.

Roof Access. In a space lease, the landlord typically wants to control access to the roof of its building because the landlord does not want tenants to damage the roof and/or void the landlord's roof warranty. In a restaurant lease, however, the tenant's HVAC, refrigeration and exhaust equipment is often located on the roof. Therefore, the tenant needs to reserve the right, not only to install such equipment on the roof, but to also for it and its vendors to have access to the roof to maintain, repair and replace that equipment without charge to tenant or its vendors. The landlord should require the tenant to use the landlord's roofing contractor for any roof penetrations, and the tenant should agree to this requirement, provided the tenant should add a caveat similar to the following:

> In connection with any roof penetrations, Tenant shall use Landlord's designated roofing contractor; provided, however, such roofing contractor shall be available to perform such work in a timely manner so as to not delay Tenant's construction schedule (or delay any necessary repairs or replacements) and such contractor shall charge competitive market prices for the metropolitan area in which the shopping center is located.

Pest Control and Health Inspection Grades. Landlords want to ensure that restaurants exterminate regularly and want approval rights over the tenant's pest control vendor. Tenants, however, will want to handle pest control with their preferred pest control vendor and will not want to regularly provide reports to its landlord, unless it receives a specific request from the landlord. In food court areas, the landlord will insist that all the food court tenants use

landlord's pest control vendor. In such cases, or in cases where a tenant shares a building with other food service providers, the tenant will want a remedy if it is being adversely affected because the landlord's required pest control vendor is inadequate, or neighboring food service providers, including movie theaters, are not keeping their premises pest free. In addition, increasingly, landlords are attempting to require that the tenant always maintain an A grade from the applicable health inspector and making it an automatic default under the lease if such A grade is not continuously maintained by the restaurant. The tenant should push back on this requirement and insist that the general obligation to maintain its premises in good condition and repair and to operate for the permitted use, (however that has been described), is sufficient. If the tenant ultimately agrees to some sort of requirement related to its health score, the tenant must ensure this provision is not an uncurable default and that it is given time to address the reason for its failure to maintain an A health grade. In addition, the tenant needs to carve out reasons that are not within the tenant's control, such as pests coming from a common area under landlord's control or from a nearby tenant.

Hours of Operation. Landlords typically request that the tenant be open and operating for a certain number of hours (typically "the normal hours of the shopping center as established by Landlord from time to time" or express operating hours). A restaurant tenant cannot agree to this requirement. For instance, a restaurant offering breakfast likely opens at 7:00 a.m., which is far earlier than "normal shopping center hours." Similarly, a full-service sit-down dining restaurant may open later and stay open far longer than retail tenants. All tenants, but particularly restaurant tenants, should avoid stated hours of operation, if possible, but for restaurant tenants, it is especially important because some restaurants (particularly local operators) may give their managers the right to decide to close early if the business does not support the restaurant staying open on a certain day. In addition, many restaurants are closed on Mondays, while most retailers are open, so the restaurant operator needs to ensure that it has the right to close on Monday without penalty. From the landlord perspective, the landlord can solve for this problem by requiring that the tenant be open for lunch and dinner at least six (6) days a week or that the tenant be open a minimum of forty (40) hours a week. For higher end specialty restaurants, the tenant may not want to be open for lunch, so the tenant needs to ensure that it is permitted to serve dinner only. From the landlord perspective, particularly in an office building setting, the landlord wants even the high-end specialty restaurant to be open for lunch as an amenity to its office tenants. In this instance, the parties may agree that the tenant will initially open for lunch and operate for lunch for a certain number of years with the right to cease operating for lunch thereafter. This provision can be further negotiated to allow the tenant to cease operating for lunch only if the gross sales derived at lunch for the preceding "x" number of years are below a certain threshold established in the lease.

Delivery Hours. Restaurants may have different vendors delivering food products, many of which may have a limited shelf life or require refrigeration. Restaurant tenants should attempt to have the right to allow its vendors to deliver food at any time, as the tenant is often unable to control exactly when the vendors will deliver the food. The landlord, on the other hand, will want to restrict when, where and how (including path of travel) these vendors can deliver their products to the restaurant, particularly in high-end office or residential buildings and transportation centers. Attention should be paid to the rules and regulations set forth in the lease that may be too restrictive for a typical restaurant tenant that needs flexibly to accept these important deliveries.

Parking.

- **To-Go or Short-Term Parking.** To-go or short-term parking has become more prevalent in recent years. COVID and the strong demand for deliveries by third parties such as Uber Eats and Grubhub have changed the landscape with respect to the right to designate to-go or short-term parking spaces. The restaurant tenant will want a specific number of signs that specifically identify the tenant's tradename. In some instances, the landlord may only want to (or be permitted to agree to) allow general short term parking signs that are available for all customers, and which are not branded. In reviewing the title documents, be aware of any restrictions against designating to-go or short-term parking spaces for specific users. From a landlord perspective, when preparing and negotiating REA's on the front of the development and leases, the landlord should expressly reserve the right to designate certain short term parking spaces for the benefit of certain users, notwithstanding a non-exclusive easement granted to all users of the center for parking. From the tenant perspective, while the restaurant tenant wants the right to have the maximum designated to-go parking spaces, the tenant also does not want the landlord to be permitted to allow too many parking spaces in the center to be designated for short term parking. So while the tenant is asking for its own short term parking spaces, the tenant may also want to request that landlord limit the total number of to-go or short-term parking spaces in the center (or prohibit any to-go or short-term parking spaces, other than tenant's, in a specifically designated area, commonly referred to as a "Protected Area" or "Critical Common Area").

- **Employee Parking.** If employees are required to park in a certain area, restaurant users need to be careful to make sure that the area is close enough to the premises that it is safe for employees to leave late at night, since restaurants typically operate late and then servers and bar staff are required to stay for an additional hour or two in order to clean up. Tenants should push against the landlord having the right to relocate employee parking to an off-site location, or charging parking fees for employees. In an urban setting, a restaurant tenant in an office building or hotel that is served by a parking garage, should confirm if the its employees will be permitted to park in the parking garage. The restaurant tenant will want the landlord to agree to provide a certain number of parking spaces in the garage for free for the use of its employees. In many urban settings, however, the garage is leased out or managed by an unrelated parking management company. In this instance, it is unlikely the landlord will (or is permitted to) grant free parking (particularly for large format restaurants who may require upwards of 50 employees per shift). If the landlord is not willing or permitted to grant free parking for the tenant's employees, often the tenant will negotiate a small number (4 or 5) of free parking spaces that is available for its managers and the tenant will agree to pay for parking (hopefully discounted) for an additional number of employees.

- **Valet Parking.** High-end restaurants and certain higher-end projects present another issue when it comes to valet parking. If the tenant requires a valet parking service, then the tenant and landlord must agree upon numerous items related to valet:

    - Will landlord or the tenant be responsible for running the valet service?
    - Will the valet service be shared with other occupants (in which case landlord should be responsible for running the valet) or will the valet be for the exclusive use of the tenant (in which case it may make more sense for tenant to run the valet).
    - If the tenant will run its own valet service, the tenant needs to ensure that there is an area (ideally that tenant may cone off) that is exclusively for the use of tenant's valet service, and tenant needs to reserve the right to use such area during all hours that tenant is running valet (for instance, perhaps the tenant will only run valet for dinner, in which event, the tenant will want the right to cone off spaces starting at 4:00 or 4:30, but if the tenant needs valet at lunch, it will need the right to reserve such spaces during lunch too, in which case, perhaps the landlord and tenant agree to fewer spaces for lunch than dinner).
    - If the landlord is running the valet, the tenant also needs to ensure that the valet parking spaces are sufficiently close to the premises to allow an acceptable "fetch" or "retrieval" time, so tenant would request that any valet parking service operated by tenant shall have a "fetch" time of less than five (5) minutes.
    - If the landlord is running the valet, the tenant also needs to confirm (and control) the cost to tenant and/or its customers. A restaurant tenant may require that valet parking be operated by landlord, but require its customers to pay for it. In such case, a restaurant needs to require that the price for such valet is consistent with market prices in the area in which the project is located. Note that you should also confirm market prices when entering into a restaurant lease, as the prices may vary greatly from one market to another. If the tenant is going to validate parking or pay landlord to provide free valet, the tenant should also require a "most favored nations" provision which would prohibit the landlord from giving another restaurant operator in the project a more favorable price for the valet.

- **Protected Area.** For any tenant, but particularly restaurants who are very heavy parking users, as important as it is to confirm sufficient parking is available for its use, it is equally important to control available parking in the remainder of the shopping center to confirm sufficient parking is available. One way to do this is to require the landlord to agree to meet certain parking ratio requirements, which may be in excess of those required by applicable law. Unless you are an anchor tenant or negotiating an REA or other similar document at the front end of a deal, the landlord is not likely to allow you to impose additional parking ratio requirements. At a minimum, the tenant may simply require that the landlord meet all applicable parking ratio requirements per code, as of the effective date without variance. An alternative way to ensure that a sufficient parking field exists is for the landlord to agree to a "no build area" or "protected area concept" over a portion of the center to ensure that a portion of the center located in close proximity to the tenant remains available for parking and will not be eliminated or used for other purposes. The landlord will want to limit the "protected area" concept to a "no build area" which simply requires that no buildings may be constructed in the no build area rather than giving the tenant any right to approve modifications to such area, which should be acceptable to the tenant if the intent of the no build area is to ensure the same remains parking. In addition, the tenant should request that there is no valet parking, no

specifically designated employee parking, and no snow stockpiling permitted within the "protected area" or "no build area."

Drive Thru Stacking Concerns. If the tenant plans to operate a restaurant with a drive-thru and/or will be located near another tenant that is operating a drive-thru, it is important to add an exhibit to the lease that shows how the cars waiting in the drive-thru lane will stack up, particularly when the number of cars waiting is beyond the boundaries of the drive-thru lane(s). This can create serious traffic concerns if other common area roadways are blocked or worse, if cars stack up into another tenant's parking spaces or into the adjoining public roads. The landlord should impose minimum stacking requirements (i.e., tenant shall provide enough room for stacking of "x" amount of cars). The landlord can also control the effect of a drive thru on the remainder of the landlord's shopping center by retaining plan approval rights.

Patio Areas or Outdoor Sidewalk Seating. From a monetary perspective, while this is not typically controversial, the square footage of the patio area should not be included in any calculation to determine base rent and additional rent that is charged a square footage basis. , A tenant should, however, be obligated to otherwise treat the patio area as part of the premises (for instance, all maintenance, indemnity and insurance obligations typically apply). If the restaurant's premises includes use of an outdoor patio area exclusive to the tenant, there may be additional limitations on patio operations that apply to the patio and not the interior of the premises. The landlord will want to ensure that the noise from use of the patio, including any music, will not disturb other tenants, particularly if residential tenants live nearby, and as such, the landlord should attempt to prohibit the playing of any music on the patio. It is important to understand the restaurant tenant's concept (i.e., do they typically play live music on the patio or do they play recorded music). If the tenant does not intend to have any live music, typically landlords will agree that recorded music may be played on the patio at decibel levels that comply with all noise ordinances. If the tenant does intend to have live music on the patio, the parties may need to agree to limited hours where live music is permissible and/or what types of live music is permissible (i.e., one man and his guitar may be acceptable where a full rock band may not be). Also, given the high visibility of the patio area, landlords will want to approve the patio furniture. In this instance, particularly if the tenant is a national tenant with prototypical patio furniture, the tenant should attempt to obtain landlord's consent to tenant's prototypical patio furniture as part of the lease. Further, the landlord will want to impose additional cleaning obligations on the patio, including the obligation to power wash the patio, and if the tenant fails to maintain the patio area in accordance with the terms of the lease, the landlord typically wants a very short cure period (versus the normal 30-day cure period for non-monetary defaults) before landlord has the right to exercise self-help and charge back the cost to the tenant. Further, the landlord will typically ask for the right to terminate the tenant's right to use the patio permanently, without terminating the lease or tenant's right to possession, if the landlord determines the tenant is not using and maintaining the patio area in compliance with the lease. The tenant should not agree to allow landlord to terminate tenant's right to the use of the patio. The tenant should argue that landlord has default remedies, and if tenant's failure with respect to the patio is material enough that landlord no longer wants the patio to be used, then landlord can exercise its default remedies. Tenants will also not want the landlord to have right to just permanently terminate the tenant's right to use the patio area if the landlord believes the tenant is not complying with its lease. The tenant will want the landlord to instead treat the alleged non-compliance like any other non-compliance of the lease. The tenant will also want the landlord to consent to any permit or license applications (including renewals thereof) that may be required by the jurisdiction having authority over the patio area.

Utility Interruptions. A utility interruption for a restaurant, caused by the landlord, whether intentionally or otherwise, will likely cause more damage than a similar utility interruption to a general retailer, because electricity is essential for maintaining food safety and preserving perishable items. As such, in addition to the generally negotiated language regarding rent abatement in the instance of a utility interruption, a restaurant user should have the right to exercise self-help (i.e., to obtain a generator) and charge the landlord for the costs incurred in connection therewith to mitigate tenant's damages., For example:

> The interruption of any utility serving the Premises caused by Landlord, its agent's, employee's, or contractor's negligent or willful actions shall, in addition to other remedies available to Tenant under this Lease, cause an abatement of all Rent due from the twenty-fourth (24^{th}) consecutive hour of such interruption after Landlord has been notified thereof (which notice may have been by e-mail, text message or telephone call to Landlord or its property manager) until such time as the interrupted utility is restored, and if such interruption is not cured by Landlord within three (3) hours after it occurs, then Tenant may, at its option, take such steps as are reasonably necessary to cure and/or mitigate the impact of such interruption itself (including renting portable generators), in which event Landlord shall

reimburse Tenant for the reasonable and actual out-of-pocket costs incurred by Tenant in connection therewith.

In addition, in a space lease, landlords typically preserve the right to enter the premises to perform certain maintenance and/or to run utilities for the use of other premises in the building. While all tenants have an interest in controlling this entry and place certain restrictions on landlords ability to do work in the space, from a restaurant tenant perspective, if any such work will require a cessation of electricity, you want to require the landlord to provide temporary power during such entry (through the use of generators or otherwise) to avoid an interruption in food and beverage refrigeration.

V. PERCENTAGE RENT/GROSS SALES

While all retailers have a laundry list of exclusions from gross sales for purposes of calculating percentage rent, certain exclusions are particular or more critical to a restaurant. Some of these additional exclusions are as follows:

- Tips or other gratuities given to a restaurant tenant's employees;
- Employee meals (or portions thereof) for which no charge was made, or which were discounted;
- Food delivery charges and delivery fees to the extent that such amounts are paid by the tenant to unaffiliated third parties (i.e. UberEats, Grubhub, etc.);
- Any amounts received by or from tenant's valet service, if applicable;
- Any transaction where no consideration was received by the tenant, such as, but not limited to, "walk outs" (patrons leaving the premises without paying for goods and services received), bad transactions net of recovery (if and only to the extent the subject transactions were included in gross sales), or payments made with counterfeit currency;
- Meals donated to charities; and
- The discounted portion of sales (e.g., if an entrée which may normally cost Twenty and No/100 Dollars ($20.00) was sold at a special price of Fifteen and No/100 Dollars ($15.00), or for which the customer had a Five and No/100 Dollars ($5.00) coupon, then only the Fifteen and No/100 Dollars ($15.00) paid will be included in gross sales).

The landlord should try to limit certain exclusions from gross sales to a certain percentage of gross sales (i.e., employee meals for which no charge was made, or which were discounted, shall be excluded from gross sales, not to exceed 2% of gross sales).

VI. FORCE MAJEURE CONSIDERATIONS

Restaurants that relied on indoor dining, as opposed to drive-thrus or to go/delivery orders, were hit very hard during the Covid pandemic. Force majeure clauses should expressly include pandemics, epidemics, disease, public health emergencies and imposition of governmental regulations in connection therewith. In negotiating any force majeure relief for future required closures, tenants who mostly rely on sales from on-premises dining and do not have a drive-thru will want rent relief if on-premises indoor dining is reduced or prohibited due a force majeure event based on events like the Covid pandemic or other governmental closures beyond the tenant's control. The landlord, on the other hand, likely has a mortgage payment, tax payments, insurance and maintenance obligations, regardless of whether the tenant is open and operating, and therefore, the landlord should push back to either limit the time of any abated rent payments, the amount of any abated rent payments (i.e. limited to fixed rent only and all additional rent remains due and payable) and the circumstances under which there is no abated rent (i.e., if tenant has a drive-thru or is permitted to offer take-out dining, then no abated rent). In addition, the landlord may offer deferred rent, in lieu of an abatement, in which event, the tenant may have the right to cease paying rent (or a portion thereof) during a period of closure (capped at a certain amount of time), but that time period may be added on at the end of the term, or the tenant may be obligated to pay such deferred rent back over a period of time after re-opening for business.

VII ALCOHOL

Insurance. If the tenant serves alcohol, landlords should require that the tenant maintain additional liability insurance commonly referred to as "dram shop" insurance. The tenant should limit this requirement to when the tenant is open for business and serving alcohol, as opposed to as of the date of the lease or the date tenant takes possession, particularly if the tenant is expected to be under construction for a lengthy period. Landlords will typically require that tenant name the landlord as an additional insured on its liquor liability policy, however, the

tenant should check with its insurance carrier before agreeing to this language. Some insurance providers take the position that the landlord cannot be named as an additional insured on a separate liquor liability policy because the landlord does not have an insured interest; however, if the insurance coverage is carried as part of the tenant's commercial general liability policy (i.e., in such instance the policy is endorsed to delete the exception for coverage for liability arising from serving alcohol), then the landlord can be named as an additional insured on such policy.

Purchase of License. In some instances, the tenant may purchase the license from the landlord, and the landlord will have the right to repurchase the license from the tenant upon the expiration of the term of the lease. Even if the license was not purchased from the landlord, the landlord may attempt to have a right to purchase the license upon expiration of the lease term. Most tenants have separate alcohol licensing counsel from their leasing counsel, so it is important for the party drafting the lease to confirm any licensing requirements with the licensing counsel.

Termination Right if Tenant Fails to Obtain Alcohol Licenses. If serving alcohol is critical to the success of the restaurant, a tenant must have the right to terminate the lease if it is unable to obtain the alcohol license, or otherwise include this license as part of the due diligence or permitting period contingency that may be in the lease. Alcohol licensing is extremely state specific and there may also be local legal requirements, depending on where the restaurant is located. Tenants should retain local alcohol licensing counsel to ensure the lease contains any protections or other provisions needed in connection with the tenant's alcohol license. In addition, in many states, the licensing authority requires the landlord to provide certain information in order for the tenant to obtain a liquor licensing (and not surprisingly, the members or principals of the landlord do not always want to provide this personal information). The tenant should include language in the lease that requires the landlord, at no cost to it, to cooperate with tenant to obtain its liquor license, including the disclosure of information on the landlord and its business principals. The landlord may object to providing any information related to its business principals, in which event, leasing counsel should check with the restaurant tenant's licensing counsel to confirm that such information is not required in the applicable state.

VIII. SUMMARY

While restaurant and retail tenants have many similar concerns, the foregoing sets forth some of the different concerns between the two different uses, primarily due to the nature of the restaurant business, its build-out, and unique operational requirements. Restaurants require specialized equipment, ventilation systems, and waste management solutions, which can be more complex and costly compared to general retail operations. Landlords have justifiable reasons to attempt to control those matters in a restaurant lease, while tenants understandably want the greatest flexibility to operate their business at the lowest cost possible. While these matters require diligence and patience while negotiating a lease, restaurants are a key component to any commercial development, and ultimately the landlord and tenant will work together to find a middle ground on these challenging issues.