Hospitality, Food and Beverage Industry Newsletter

November 2015

In This Issue

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From the Co-Chair:

We are pleased to share the first edition of our Hospitality, Food and Beverage Industry Newsletter with you. This Newsletter addresses important recent legal developments affecting the hospitality and restaurant industry and we hope it is a valuable source of information for you. Please feel free to pass along the Newsletter to anyone who may be interested in the articles or our team's expertise in the hospitality industry.

Our Hospitality Practice Group has decades of experience counseling businesses in the hospitality, restaurant, and food and beverage industry. We represent publicly and privately held international and national restaurant chains, stand-alone restaurants, hotel chains and hotel management companies, franchises, fast food chains, food and beverage companies, resorts and spas, golf courses, stadiums, and investors and lenders in the hospitality and restaurant sectors. We understand the needs and challenges of the hospitality and restaurant industry and counsel clients on every aspect of their business, including labor and employment matters, tax planning, corporate acquisitions and mergers, financing, licensing, litigation, trademark and copyright matters, leasing, zoning and development issues, real estate acquisitions and sales, and insolvency and restructuring.

Our talented team of professionals in the Hospitality Practice Group are available to answer any questions you may have on the topics in this Newsletter or any other legal issues affecting the hospitality, food and beverage industry.

Kalley R. Aman
Co-Chair of the Hospitality, Food and Beverage Industry Practice Group

A Wake Up Call To Franchisors: The Big Mac Attack

Michael R. Newhouse and Ruth L. Seroussi

In the wake of recent activity by the National Labor Relations Board (NLRB) concerning unfair labor practice charges against McDonald's franchisees and franchisor McDonald's, USA, LLC, coined by some as the "Big Mac Attack", franchisors have become concerned that the landscape may be shifting with respect to the traditional franchisor-franchisee relationship, and potential franchisor liability for the acts and omissions of franchisees.

Typically, "one owes no duty to control the conduct of another, or to warn those endangered by such conduct," absent a "special relationship." *Zelig v. County of Los Angeles*, 27Cal.4th 1112, 1129 (2002). Importantly, with respect to franchisors, "[a] typical franchisee-franchisor relationship does not constitute a "special relationship." *Wickham v. Southland Corp.*, 168 Cal. App.3d 49, 61-62 (1985). However, California Civil Code Sec. 2307 provides that "an agency may be created and an authority may be conferred by a precedent authorization or a subsequent ratification."

In light of this well established authority, the franchisor's analysis has always centered on the "creation" or "ratification" of such authority. Traditionally, creating or ratifying an act or omission of a franchisee normally requires the franchisor to have actual awareness surrounding a situation. However, willful blindness or an unreasonable failure to investigate can be sufficient to establish franchisor liability. "Ordinarily, the law requires that a principal be apprised of all the facts surrounding a transaction before he will be held to have ratified the unauthorized acts of an Agent. However, where ignorance of the facts arises from the principal's own failure to investigate and the circumstances are such as to put a reasonable man on inquiry … he may be held to have ratified despite full knowledge." *Reushe v. Cal. Pacific Title Ins. Co.*, 231 Cal.App.2d 731, 737 (1965).

In addition to creation or ratification of franchisee authority, aiding and abetting is also a potential liability for franchisors in the rare event that the franchisor had knowledge of the franchisee's bad acts, and took some steps that substantially assisted the wrongful act. *Peel v. BrooksAmerica Mortg. Corp.*, F.Supp.2d 2011 WL 2174373, *7 (C.D. Cal.June 1, 2011). Such acts are generally uncommon, but must be part of any analysis of potential franchisor liability.

In any event, and as briefly discussed in the introduction to this article, in the wake of the NLRB's McDonalds' complaints, franchisors should also be keenly aware of a new area of potential joint employer liability with their franchisees.

With respect to those complaints, in the summer of 2014, the NLRB's Office of the General Counsel investigated charges alleging that McDonald's franchisees and their franchisor, McDonald's, USA, LLC, violated the rights of employees under the National Labor Relations Act (NLRA) as a result of activities surrounding employee protests. The disciplined workers claimed McDonalds illegally fired, threatened or otherwise penalized them for their pro-labor activities.

In a departure from similar cases, in December 2014, the NLRB issued complaints against McDonald's, the franchisor, saying it is jointly responsible with its franchises for unfair labor practices. The NLRB found that McDonald's, the franchisor, exercised so much control over its franchisees that it was the "top boss", noting that McDonald's requires franchise owners to strictly follow its rules on food, cleanliness and employment practices and that it often owns the restaurants that franchisees use. In reaching its conclusion, the NLRB employed a more lenient "industrial realities test" rather than its more recent "joint employer" standard.

Under the recent "joint employer" standard, a franchisor must share or jointly determine those matters governing employee's working conditions and terms of employment in order to be found to be a joint employer under the NLRA. The proposed "industrial realities test" is more relaxed, finding a joint employment relationship if a franchisor exercises control over day-to-day operations of franchisees, regardless of whether the franchisor exercises any direct control over the franchisee's employees.

Following in the aftermath of this "Big Mac Attack", on April 28, 2015, the NLRB issued an advice memorandum addressing when franchisors may be considered joint employers with franchisees for purposes of the NLRA. In the advice memorandum, the NLRB found that a restaurant franchisor and its development agent were not joint employers with a Chicago-based franchisee under either the prior "joint employer" standard or the "industrial realities test." The franchisor's control over the franchisee in that instance was limited to product and brand quality protection (i.e., regulations regarding food preparation, recipes, menu, uniforms, décor, store hours and initial employee training prior to the franchise opening) to ensure "a standardized product and customer experience, factors that clearly do not evidence sharing or codetermining matters governing the essential terms and conditions of employment."

Notwithstanding the advice memorandum, the departure by the NLRB from its more recent "joint employer" standard is obviously causing grave concern throughout the hospitality industry. Many contend that the NLRB's position undermines the idea that the franchisee, not the franchisor, is generally responsible and liable for any legal violations, concerning negligence, wage-and-hour violations, discrimination, among other things. Franchisors need to be sure to maintain the requisite separation between franchisor and franchisee to avoid a joint employment relationship, and should confer with competent counsel to help make that determination.

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What the Hospitality Industry Needs to Know about Website Accessibility Guidelines

William Miller

Do private businesses, including restaurants, hotels and travel businesses who offer services to the public through their website (i.e., sell a product or service on the website) have to make their websites accessible to persons with disabilities? While the answer to that question is almost certainly “yes,” it has still not been conclusively answered by either Congress or the California State Legislature. What we do know is that such businesses *can be sued* for having an inaccessible website, and that it makes sense to take all readily achievable efforts to meet the website accessibility standards as described herein.

Presently, it remains unclear whether Title III of the American’s with Disabilities’ Act (“ADA”) or California’s Disabled Persons’ Act, as currently enacted, require that websites for places of public accommodation be accessible to persons with disabilities. Even though the legislature has not acted, the Department of Justice (“DOJ”) has made clear that it believes that Title III of the ADA does apply to websites and has been considering several different types of regulations since at least 2010.

For several years, Title II of the ADA has required state and federal government entities to make their websites accessible, and there are currently regulations regarding what is necessary for compliance. But, it is unlikely that the Title II regulations will be adopted to apply to private businesses. While there are some competing regulations, most observers believe that the DOJ will eventually adopt some version of the Web Content Accessibility Guidelines (“WCAG”) 2.0 AA.[1] The WCAG 2.0 AA guidelines currently serve as the international standard with many countries already adopting the regulations. They are more comprehensive than the current regulations that apply to federal and state websites under Title II of the ADA.

While the fact that it has been more than four years since the DOJ’s initial comments regarding web accessibility, there is still no date certain for when regulations will issue (or what the final regulations will say). The most recent guidance from the DOJ indicates that it does not intend to issue any proposed regulations for public accommodation and websites until at least April 2016. Some have suggested that the delay in the promulgation of regulations is due to the required cost-benefit analysis. Indeed, the WCAG 2.0 AA are extremely technical, and if adopted will require hundreds of thousands of businesses to employ a consultant to ensure compliance—likely at not insubstantial cost.

Despite the lengthy delay in providing regulations, in its Advanced Notice of Proposed Rule Making in July 2010, the DOJ stated that “[a]lthough the Department has been clear that the ADA applies to websites of private entities that meet the definition of ‘public accommodations’, inconsistent court decisions, differing standards for determining Web accessibility, and repeated calls for Department action” have compelled the DOJ to explore creating a uniform standard for web accessibility under Title III of the ADA.

Consistent with its prior statements and despite the lack of guidance regarding how a business’ website must comply with Title III of the ADA, the DOJ has taken the position that it does apply, and has intervened in several private actions to enforce the law. For example, in March 2014, the DOJ, after intervening in a lawsuit originally brought by the National Federation of the Blind of Massachusetts, entered into a consent decree with H&R Block that required H&R Block to make its website and mobile applications accessible under the WCAG 2.0 AA guidelines.

What this means for private businesses is that even though there is no official guidance on what is necessary for a website to comply with Title III of the ADA, a business can be sued right now for having an inaccessible website. Accordingly, businesses that offer services to the public through their website (particularly if they are selling a product or service on the website) should make their websites compliant with the WCAG 2.0 AA. While there is no guarantee that the WCAG 2.0 AA guidelines will be adopted, as discussed above, they have been included in at least one consent decree and seem to be the most likely candidate to be adopted in some form. Therefore, if a business’ website meets those standards prior to the DOJ promulgating its rules, it will be in the best position to defend a lawsuit alleging its website is not accessible and very likely will be ahead of the regulations once they are issued.

In short, if your website is not already compliant with WCAG 2.0 AA, it is prudent to take all readily achievable efforts to meet those standards.

[1] The WCAG guidelines were created by the Web Accessibility Initiative of the World Wide Web Consortium (“WC3”). The WCAG 2.0 guidelines are the second iteration of these voluntary international guidelines for web accessibility. The “AA” guidelines denote an intermediate level of access, which contain enhanced criteria for more comprehensive accessibility that is still achievable by web developers. That is why the WCAG 2.0 AA guidelines are the most likely to be adopted.

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Combating Employee Misclassification under the FLSA

Jeffrey H. Kapor and Audrey S. Olson

Correctly classifying a worker as an employee or an independent contractor is critical. Misclassification of employees as independent contractors has been occurring in an increasing number of workplaces, and the Department of Labor's Wage and Hour Division is responding by bringing enforcement actions against employers who misclassify their workers.

In order to combat misclassification, the Administrator of the Wage and Hour Division of the U.S. Department of Labor recently issued an Interpretation providing guidance as to who the Department of Labor believes should be classified as an employee under the Fair Labor Standards Act ("FLSA"). It states that employer labels do not determine a worker's classification. Instead, courts use a multifactorial "economic realities test" to determine whether a worker should be classified as an employee or an independent contractor under the FLSA. By using this test, the goal is to determine whether a worker is economically dependent on the employer (and thus an employee) or whether the worker is in business for him or herself (and thus an independent contractor).

Although the Administrator's Interpretation does not have the force of law or regulation, it very well may be afforded deference by the courts, and we therefore recommend that employers review the following six factors identified by the Administrator under the economic realities test in order to ensure that they have accurately classified their workers. When reviewing these factors, it is important to remember that no single factor is determinative, and that courts may consider additional factors depending on the circumstances. These factors should simply be used as guides to answer the ultimate question of whether a worker is economically dependent on the employer, and thus an employee:

1. **The extent to which the work performed is integral to the employer's business:** If the work performed is integral to the employer's business, like the work a carpenter would do for a construction company, the worker is more likely to be considered economically dependent on the employer, and thus an employee. Conversely, a true independent contractor's work is unlikely to be integral to the employer's business, such as a software developer who creates software that assists a construction company in tracking its bids and material orders.

2. **The worker's opportunity for profit or loss depending on his or her managerial skill:** If the worker has an opportunity for profit or loss, and has an ability to make decisions to use his or her managerial skill and initiative to affect that opportunity for profit or loss, the worker is more likely to be an independent contractor. This factor does not focus on a worker's ability to work more hours, which does little to distinguish an employee from an independent contractor.

3. **The extent of the relative investments of the employer and the worker:** In order to be considered an independent contractor, the worker should have made some investment or undertaken some risk which is significant in nature and magnitude relative to the employer's investment in its overall business. A relatively minor investment by the worker that does little to further a business beyond the employer's investment suggests that the worker and the employer are not on similar footings and that the worker is economically dependent on the employer, and thus an employee.

4. **Whether the work performed requires special skills and initiative:** The fact that workers are skilled is not itself indicative of independent contractor status. Instead, the inquiry is whether the worker uses his or her skills in some independent way, such as demonstrating business-like initiative. If he or she does so, the worker is more likely to be an independent contractor.

5. **The permanency of the relationship:** Permanency or indefiniteness in the worker's relationship with the employer suggests that the worker is an employee rather than an independent contractor, who typically works one project rather than on a continual basis. However, a lack of permanence does not automatically suggest an independent contractor relationship. The reason for the lack of permanence should be carefully reviewed to determine if the reason is indicative of the worker running an independent business.

6. **The degree of control exercised or retained by the employer:** In order to qualify as an independent contractor, the worker must control meaningful aspects of the work performed such that it is possible to view the worker as a person conducting his or her own business. The nature and degree of the employer's control must be examined as part of determining the ultimate question of whether the worker is economically dependent on the employer.

The Administrator notes that any analysis of these factors must be consistent with the FLSA's expansive definition of "employ" as "to suffer or permit to work" and should be guided by the FLSA's statutory directive that the scope of the employment relationship is very broad. The Administrator claims that, under the FLSA's broad definition of employment, "most workers are employees" under the FLSA. Accordingly, employers should carefully review the above listed factors and consider their relationships with their workers in order to avoid liability resulting from misclassification under the FLSA, and a potential action by the Department of Labor to collect back pay for minimum wages and overtime due to an employee who the Department of Labor believes has been misclassified as an independent contractor.

Moreover, although the test for independent contractor status differs somewhat in other contexts, the misclassification of employees as independent contractors has ramifications beyond

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Tip Pooling Tax Implications—What Employers Need to Know

Stuart Simon

The sharing of tips is referred to as "tip pooling," "tip splitting," or "tip sharing." For purposes of this discussion, we will refer to the sharing of tips as tip pooling.

Tip pooling occurs generally in two forms. First, the waiter or other tipped employee receives a tip and the tip is shared with fellow employees, such as bussers, bartenders, runners and hosts. The second form of tip pooling generally is where all employees who receive tips combine their tips and divide the tips among themselves.

The waiter or other directly tipped employee need only include in income the share of tips received, reduced by the payout to the other employees.

However, the other employees receiving the share of tips must report their tips as income. An indirectly tipped employee is treated the same as a directly tipped employee.[1] This is the source of increased reporting and withholding requirements for employers generated by tip pooling.

All employees that receive tips, directly or indirectly, must maintain a daily tip report. The daily reports are maintained on Form 4070A, Employee's Daily Record of Tips (Form 4070A-PR in Spanish). If the daily tip reports are maintained by the employer in an electronic system, the employee must be given a paper copy.

Note that in situations where there is a mandatory service charged added to a restaurant bill or a catering charge, such as an 18% charge for a party of six or more, that charge is not a tip or gratuity as it is not a voluntary payment. To the extent that all or a portion of the mandatory service charge is distributed to the employees, the amount distributed is reported as payroll, not tips.

Once a month, the directly tipped and the indirectly tipped employees must give the employer a summary of the tip income on Form 4070, Employee's Report of Tips to Employer. The report is due within 10 days of the month-end. Employees who do not report the tips as required are subject to a penalty equal to 50% of the social security, Medicare, and Additional Medicare taxes due on the tips. The Form 4070 provides for the total cash and credit card tips received by the employee and a deduction for amounts paid to other employees, arriving at the net tip income.

The employer has a complicated withholding function as the result of tip pooling and the requirement to withhold from both directly tipped and indirectly tipped employees. Once an employee reports the tips to the employer, the tips are treated as wages "paid" by the employer as of the time of the report. The employer must then withhold the income taxes, social security taxes, Medicare taxes and additional Medicare taxes as if the tips were regular wages. However, the employer must withhold only to the extent that he can collect the tax at any time before the end of the year and if the employee's social security taxes, Medicare taxes and additional Medicare taxes on tips are first deducted in full from such sources. The employer is not required to make up any deficit in withholding other than from funds the employee voluntarily supplies. Any funds the employee voluntarily pays the employer are first applied to the employee's social security, Medicare or Additional Medicare taxes. The employer must notify the employee if funds under the employer's control are insufficient to pay the social security, Medicare and Additional Medicare taxes due. The employee will need to pay the amounts directly when the employee files the individual income tax return.

Employee can be given copies of Publication 1244, Employee's Daily Record of Tips and Report to Employer (which includes the Forms 4070A and Form 4070) for their maintenance of their tip records. If an employer prefers, an electronic system for tips may be maintained by the employer. In any situation, it will be essential that the employer have a method of being sure that employees receiving tips, directly or indirectly, through tip pooling report their tips.

[1] Reg. 31.6053-3(j)(13).

[2] IRC 3402(k).

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Combating Employee Misclassification under the FLSA

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the FLSA. For example, misclassification also implicates the IRS. Because an employer has to withhold certain taxes (i.e., income, Social Security and Medicare taxes) in the case of an employee but not an independent contractor, misclassifying an employee as an independent contractor may result in an action by the IRS to collect any and all withholdings that were due.

Misclassification is also likely to result in lawsuits instituted by misclassified employees themselves. For example, misclassified employees will claim such things as an entitlement to an hourly minimum wage, overtime compensation, family and medical leave, unemployment insurance and workers' compensation insurance. Misclassification of these individuals as independent contractors therefore places an employer at risk of being sued for enforcement of any employment rights that allegedly were denied to these workers.

Finally, employers also will have to consider and comply with the laws of the states in which they operate. For example, California has somewhat different tests that are applied in various contexts to determine whether a worker is an employee or an independent contractor.

In sum, while discerning whether a worker is an employee or an independent contractor may not be a simple task, the potential consequences of misclassification justify taking the time to review the classification of your workers. If you would like assistance in reviewing your policies or analyzing a worker's classification, contact counsel to determine the best course of action for your company.

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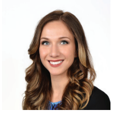

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Dealing with Restaurant and Retail Leases in Bankruptcy

Anthony J. Napolitano

The recent Great Recession and the wave of bankruptcy filings that accompanied it presented a number of challenges for landlords and tenants. Yet, as the economy has recovered, we still continue to see restaurant and retail chains turn to the bankruptcy court's for relief. Over the past year, a number of restaurants and retailers filed bankruptcy petitions. For example, American Apparel, Radio Shack, Anna's Linens and Hot Dog on a Stick have sought protection from the bankruptcy courts. As this trend continues, both lessors and lessees need to be aware of the issues involved with a potential lease workout and bankruptcy.

Bankruptcy Basics for Landlords and Tenants

A tenant can file a bankruptcy petition under either chapter 7 or chapter 11 of the Bankruptcy Code. Under chapter 11, the debtor seeks to reorganize its business, restructure its debt, and hopes to emerge from bankruptcy as a more efficient, competitive and profitable company. Under chapter 7, the debtor has determined that it cannot continue to conduct business as a going concern, and chooses to liquidate its business in order to maximize value for its creditors and equity holders.

1. The Automatic Bankruptcy Stay Protects the Tenant Debtor.

Once the debtor files its bankruptcy petition, an automatic stay immediately arises under Section 362 of the Bankruptcy Code to protect the property of the debtor's estate. This stay prohibits actions by creditors, landlords and others to (i) commence any judicial or other similar action against the debtor, (ii) exercise control over or obtain possession of property of the debtor's estate, and (iii) create, perfect or enforce any lien against property of the debtor's estate or the debtor.

For a landlord, prohibits the landlord from taking any action outside of the Bankruptcy Court to repossess the premises. There are some notable exceptions. For example, a landlord is not stayed and may seek to obtain possession with respect to a commercial lease that has terminated by the terms of the lease either before the commencement of the case or during the bankruptcy case. Alternatively, the landlord can seek to obtain relief from the automatic stay to continue with its unlawful detainer proceedings, which may be granted at the discretion of the bankruptcy judge. Failure to pay post-petition rent is one example where such relief may be granted.

2. The Tenant Debtor's Right to Assume, Assign or Reject the Lease.

Section 365 of the Bankruptcy Code deals with executory contracts and unexpired leases, and the heart of that section allows for the tenant debtor to assume (*i.e.*, retain the benefits) or reject (*i.e.*, elect to terminate) any unexpired lease. The tenant can, subject to court approval, also elect to assign the lease to a third-party. The Bankruptcy Code gives the debtor tenant 120 days from the petition date to decide to assume, assign or reject the lease. The court may, for "cause," give a debtor an additional 90 days to make such a decision. Any further extension beyond this 210-day period can only be obtained with the prior written consent of the landlord. While

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the debtor tenant decides whether to assume, assign or reject the lease, the debtor is required to pay the landlord post-petition rent, and such payments must begin within 60 days of the filing of the bankruptcy petition, unless the court extends that period for cause.

Assumption of the Lease. If the tenant wants to remain in possession of the leased premises, it must (i) cure all defaults under the lease including payment of unpaid prepetition and post-petition rent, and applicable fees and costs due under the lease, and (ii) provide "adequate assurance of future performance." The Bankruptcy Code excuses the cure of certain non-monetary defaults like breach of going-dark provisions.

Assignment of the Lease. Even though a lease may have an anti-assignment provision, the Bankruptcy Code overrides such a provision and authorizes a debtor tenant, with court approval, to assign the lease to another party interested in the location. This typically comes into play where a third party intends to acquire some or all of the debtor's business operations, or where the lease is below-market and the tenant debtor can obtain a monetary benefit from a third party willing to purchase the debtor's rights under the lease. In order to effectuate an assignment, the lease must be assumed, meaning all eligible defaults are cured, and the third-party assignee must demonstrate adequate assurance of future performance under the terms of the lease. This prevents the assignment of a lease over the objection of the landlord to a non-creditworthy third party. Furthermore, special "shopping center" provisions in the Bankruptcy Code provide landlords with further tools to prevent assignment of the lease where the proposed assignee would disrupt the tenant mix of the "shopping center."

Rejection of the Lease. If the tenant debtor determines that it no longer requires use of a particular location, it may elect to reject the lease. The tenant may also choose to reject an above-market lease, hoping to negotiate for lower rent going forward. When the lease is rejected, the tenant must vacate the premises and return possession to the landlord. Upon rejection and turnover, the tenant is no longer required to pay post-petition rent to the landlord. The landlord will then have an unsecured claim (in addition to any other claims the landlord holds) in the bankruptcy case for future rent required to be paid under the lease. This rejection damages claim cannot exceed the greater of the amount of rent due for one year or 15% of the rent due under the remaining term of the lease (not to exceed three years). Different jurisdictions are split on whether claims for physical damage to the premises are subject to the rent claim cap.

3. Lessors in Bankruptcy

Not only has the most recent economic downturn significantly impacted retailers and restaurants, it has also caused a number of property owners to seek bankruptcy protection. Under Section 365 of the Bankruptcy Code, these landlord debtors also have the right to assume, assign or reject the unexpired lease. If the landlord debtor rejects the lease, the Bankruptcy Code contains special protections for the non-debtor tenant to prevent them from being "rejected out onto the street." The tenant has two options. The first option allows the tenant to stay in the premises for the entire remaining term of the lease plus any available renewals or extensions available under the lease. The non-debtor tenant must continue to pay rent, but it also waives any damage claim against the debtor landlord resulting from the rejection. The second option allows the non-debtor tenant to vacate the premises following rejection, treat the rejection as a termination of the lease, and assert a general unsecured claim against the debtor landlord.

Strategies for Lessors in Dealing with Financially Distressed Tenant

To avoid the pitfalls of bankruptcy, a landlord needs to proactively monitor its tenants and be prepared to act at the first sign of any trouble. The following non-exhaustive list highlights some key issues that landlords need to consider in order to be fully prepared in the event of a bankruptcy filing:

1. *Financial Monitoring of the Tenant.* Landlords should consider incorporating and enforcing provisions in the lease that require the tenant to provide reports of the debtor's financial condition periodically and on demand. If the tenant's financial condition deteriorates, the landlord should consider enforcing financial covenant defaults.

2. *Security Deposits.* While obtaining a large cash security deposit is a good strategy, the deposit becomes property of the bankruptcy estate and the landlord must obtain relief from the bankruptcy court to offset against it. A letter of credit is a better alternative as a landlord can typically draw on it without having to first go through the bankruptcy court. However, the landlord should negotiate for the right to draw on the letter of credit without first having to provide a formal demand on the tenant. Otherwise, the automatic stay would prevent the landlord from issuing a notice of default to the debtor, and the benefit of the letter of credit would be undermined.

3. *Restrict Assignments*. Even though the Bankruptcy Code invalidates provisions that attempt to restrict the assignment of leases, a landlord can avail itself of the special "shopping center" lease provisions that restrict assignment under the Bankruptcy Code by clearly classifying the property as a shopping center in the lease. Since the Bankruptcy Code does not define "shopping center" courts have been relatively liberal in construing what constitutes a "shopping center."

4. *Tenant Improvements*. At the outset of the lease, landlords often provide tenants with a tenant improvement allowance to build out the premises. Typically, these TIAs are paid back through higher rent over the term of the lease. If a tenant files bankruptcy and elects to reject the lease early in the lease

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term, the landlord's rejection claim will be capped and could be paid at a significant discounted percentage. Landlords may want to consider loaning the tenant the funds to pay for the improvements and have the tenant repay those funds as a separate obligation.

5. *Compel Rent Payments*. Following the commencement of bankruptcy, the landlord should consider filing a motion seeking immediate payment of the post-petition rent obligations and to compel the debtor to make its decision to assume or reject the lease. Alternatively, the landlord can seek relief from stay to continue its unlawful detainer action, if it can show sufficient cause.

6. *Beware of Preference Liability*. If a tenant is delinquent on its rent obligations, and then makes a significant payment to the lessor, a payment made within 90 days of the bankruptcy filing can be set aside as a preference. The landlord should consider requiring a third party to make such "catch-up" payments on behalf of the debtor tenant.

Strategies for Financially Distressed Tenants in Dealing with Landlords

There are a number of issues for a financially distressed tenant to consider prior to commencing a bankruptcy case. These decisions will certainly impact the available rights and remedies of the debtor post-petition.

1. *Analyze the Relative Value of the Leases*. Prior to the commencement of bankruptcy, the tenant should analyze whether its leases are above-market or below-market and establish a plan for dealing with each of them. In bankruptcy, the debtor tenant may be able to monetize the "designation rights" related to its ability to assign below-market leases that it no longer wishes to retain.

2. *Avoid Changing the Term of the Lease*. As part of a pre-bankruptcy lease workout, landlords may require the tenant to restructure the lease and advance the termination date. Tenants should be wary of such requests, particularly converting the lease to a short-term tenancy because landlords are not subject to the automatic stay with respect to leases that are termed out prepetition or during the bankruptcy.

3. *Conserve Cash*. In order to conserve cash and build a sufficient fund to support its reorganization efforts, the distressed tenant should consider how far in advance to cease paying its monthly rent. This may provide a significant benefit if the tenant intends to vacate a number of its locations. However, if the tenant desires to assume the lease for a particular location, those payment defaults will need to be cured.

4. *Delay the Timing for Payment of Post-Petition Rent*. While the debtor tenant must pay its post-petition rent obligations, it can seek relief from the court to delay those payments to up to 60 days following the petition date. Having availability of these funds may help the debtor by permitting it to focus on other critical restructuring expenditures.

5. *Timely Seek an Extension of Time to Assume or Reject the Lease*. In order for the debtor tenant to benefit from the additional 90-day period to decide whether to assume or reject the lease, it must file its motion and the order granting such motion must be entered before the expiration of the initial 120-day period.

Concluding Thoughts

This article is not an exhaustive list of all of the possible options available for dealing with distressed leases. Landlords and tenants should thoroughly evaluate their particular circumstances with their leasing and bankruptcy counsel to decide the best overall approach for each particular situation.

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Buchalter Nemer is pleased to announce that Ruth Seroussi has been appointed to the advisory board of Cornell Institute for Hospitality Labor and Employment Relations ("CIHLER"). CIHLER was established in 2013 as a platform for students, employers, employees, unions, and their advocates involved in the hospitality industry. The institute's mission is to support educational programs, sponsor and disseminate research, and hold conferences and roundtables dedicated to the modernization of labor and employment relations, labor and employment law, human resource management, and leadership in the hospitality industry.

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About Buchalter Nemer

Buchalter Nemer is a full-service business law firm that has been teaming with clients for over six decades, providing legal counsel at all stages of their growth and evolution, and helping them meet the many legal challenges and decisions they face.

The firm is consistently ranked among the leading law firms in California by Chambers and Partners, Best Lawyers, The Daily Journal and the Los Angeles Business Journal. It is also ranked among the leading firms nationally by American Legal Media and the National Law Journal.

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