

## THE SAVVY RESTAURANTEUR—EXIT STRATEGIES IN LEASING

### Tips and traps for the owner and restaurant lawyer

OR

*134 legal and practical pointers, tips and principles every restaurateur (and leasing lawyer) must know **AS**... sooner or later your client restaurateur will want to sell the business and cash in his chips (his fish, too), or have to contemplate less balmy scenarios such as the business is failing or the location no longer works or the concept of the restaurant has become totally dated or your client's a multi-location chain and is being acquired in a bloody take-over play, **and you want to/must transfer or terminate the lease***

Presented by Jeffrey A. Margolis, Esq.  
Principal,

### THE MARGOLIS LAW FIRM

11 EAST 44<sup>TH</sup> STREET  
NEW YORK, NEW YORK 10017  
(212) 490-0900  
FAX (212) 490-0700  
[jeff@newyorkleaselaw.com](mailto:jeff@newyorkleaselaw.com)  
[www.margolislawfirm.com](http://www.margolislawfirm.com)

NOTE: This paper is based Mr. Margolis' presentation at  
ACI's Seminar: Negotiating Restaurant Leases, February 22-23, 2007,  
THEhotel at Mandalay Bay, Las Vegas, Nevada

## Introduction

The harsh realities:

- Statistics say you have 5-7 years, then your client's restaurant's concept is stale; or
- client is faring poorly in that location; or
- concept/ strategy has changed; or
- restaurant was acquired in a multi-store transfer, the acquirer now has three stores within a one mile radius, and your location is the weakest; or
- client has built a very profitable business and wants to retire, or maybe go to law school!

*Where do you go from there?*

**Be pro-active in lease negotiations and plan ahead for the inevitable.**

---

## SALE OR OTHER TRANSFER OF A RESTAURANT

### *EXIT Strategies*

### **FOCUS** on negotiation of **Assignment and Subletting** and important related lease clauses

#### 1. (Second) Introduction

*Memo to:* The Savvy Restaurant Buyer

*RE: Purchase Due Diligence*

1. Look at the lease
2. Look at everything else
3. Look at the lease again

Measure “transferability” of a lease through the assignment or sublet clauses and the qualifications (criteria) for the new tenant.

Consider the impact of:

- The obvious: The length of time left on the lease, requirement for Landlord’s consent, etc.
- The not so obvious: Silent lease issues and consequences of not knowing where to look

Onerous restrictions on the transferability of the lease can make it all but impossible to sell the business.

Be on the lookout, for example:

- signage being limited to the original, named tenant
- an obligation –per the use clause—to operate only under the “ABC” trade name
- renewal rights that disappear if lease has been assigned

***Questions to consider:***

- **When can a tenant assign?**
- **Landlord’s consent required?**
  - **Criteria for Consent?**
    - **Must landlord be “reasonable”?**
      - **How has “reasonable(ness)” been defined?**
- **Is assigning party (original tenant) still liable for rent under the lease?**
- **2. Assignment and Subletting 101**
  - Assignment (defined): transfer of tenant’s entire interest in the entire premises for balance of lease term; landlord and assignee have a direct relationship
  - Sublease (defined): transfer of less than the entire premises or less than entire balance of lease term (even if the entire balance of the term less one day); subtenant has no direct relationship with landlord, only with tenant (sublandlord)

**Privity issues**—estate and contract-- the original tenant is still liable for lease obligations—albeit secondarily.

**Surety concept**—assigning party remains liable to the landlord for performance and payment under the lease.

**3. IT’S THE LAW: TENANT’S RIGHT TO ASSIGN OR SUBLET**

General rule: Absent a statute or express restriction in a lease, a tenant has an absolute right to assign or sublet. \*

\*Caution here: A tenant may not sublet premises “to be used in a manner which is injurious to the property or inconsistent with the terms of the original lease.” *Funk v. Funk*, 633 P.2d 586, 588 (Idaho 1981).

**4. IT’S THE REALITY: LANDLORD’S RESTRICTIONS ON ASSIGNMENTS OR SUBLEASES**

***Traditional conflict in landlord’s and tenant’s points of view***

Bottom line: **bargaining power** determines the outcome

One must recognize **realities of market conditions**

## **LANDLORDS FAVOR RESTRICTIONS**

**“Give me the leeway to market my property without competition from my own tenants.”**

## **CONTROL TENANT MIX**

*Owner, not tenant, is in the real estate business*

## **Tenant’s point of view--In one word: FLEXIBILITY**

At very least: consent not be unreasonably withheld, delayed or conditioned—  
Tenant: free alienability--“I’ve invested, I’ve created value.” Or “Hey Mr. Landlord, as long as you’re getting your rent, don’t bother me” (Anonymous. Found on wall of Roman Forum Mall)

## **Tenant’s ability to assign/sublet essential to realizing the value of the business**

### **a. Landlord’s Right to Restrict**

**In some jurisdictions (such as New York)** consent can be arbitrarily refused if lease does not provide for reasonableness standard. If the terms of the lease are clear and unambiguous, the provision will be enforced without a court inquiring as to the parties’ intent. One caveat: Restricting to whom the premises is leased and/or how the premises is used constitutes a restraint on the free alienation of land and will be strictly construed.

Note **“Silent” Lease Clauses:** What if no time limit for landlord’s consent provided for in Lease? For example, if lease provides that prior to landlord making a decision as to granting consent, tenant must submit a fully executed assignment agreement or sublease, simplify the approval process: Delete fully executed assignment requirement, providing a simple term sheet will suffice.

Especially important if landlord has recapture rights.

**When Lease provides Landlord’s consent cannot be “unreasonably withheld”:**

## **(1) Standards**

- Landlord must act in an objectively reasonable commercial manner
- What is reasonable will differ depending upon the type of property, commercial office building vs. multi-use complex vs. shopping center

## **(2) Factors that may be weighed by landlord**

Proposed subtenant's or assignee's:

- financial condition—most objective
- reputation and character—most subjective
- business experience
- Identity (already a tenant in the shopping center?)
- legality of use
- conflicts with exclusive or restrictive use provisions in other leases or OREA
- nature of the occupancy—relevance to existing exclusives (shopping center)--suitability for tenant mix

Also, as to Tenant

- must be in good financial standing
- Tenant's lender must consent
- Tenant must not be in default
- The original tenant will remain liable even if it subleases

Landlord may also

- Provide certain criteria deeming specific types of occupants or types use as unacceptable
- Disallow the tenant from increasing the number of occupants and/or regular visitors who frequent the premises
- Disallow the tenant from subleasing to other tenants of the Premises
- Disallow the tenant from presenting any party presently a tenant or with whom landlord is then negotiating
- Restrict the use of the leased space to the use that is specified in the lease agreement
- Provide that any increase in rent due to a sublease (profit) must be paid to the landlords
- Require tenant must take responsibility for landlord's expenses in connection with the assignment or sublet

## **NOTES**

**Most objective test: financial responsibility of the proposed assignee or subtenant:**

**Proposed use: if same? if different?**

- Tenant mix in a shopping center—interplay with exclusives
- Warmack case: holding it was reasonable to deny consent where the tenant mix is critical:

**Q: What constitutes “unreasonableness”--bad faith?**

- Withholding consent so that the landlord may charge a higher rent than that contracted for with the original tenant

**b. Transfers by change in ownership**

**If a landlord has the right to consent, the tenant should seek to have excluded, at the very least, assignments to affiliates; assignments in connection with mergers and consolidations; and assignments in connection with a sale of all or substantially all of the tenant’s assets.**

Practice Pointer; The lease should impose no burdens at all (brokerage commissions, recapture rights, etc.) for affiliate transactions

**Merger--permitted assignment to affiliates /successors or in conjunction with sale of tenant’s business—especially if tenant operates in multiple locations—generally held not to violate a simple no assignment clause— today’s modern leases, covers all bases**

**c. Recapture**

A landlord has the authority to include a clause allowing it to recapture the space offered for assignment or sublease.

- This is anathema to the sale of the restaurant
- could help if tenant simply wanted to get out of lease (then a win/win)

#### **d. Profit**

*If landlord participates, give broad definition to tenant's expenses*

**Practice Pointer:** Don't just net out general expenses, be very specific:

- Brokerage
- Legal
- Marketing
- Advertising
- Alterations
- Takeover
- Free rent
- Cost of carrying space
- Transfer taxes
- Unamortized balance of tenant's original improvements to the space

Make sure it's only excess rent that is shared, not any other consideration received from transferee in course of the sale

Look out for unlimited expense reimbursements for landlord's consent (legal etc)

#### **5. RELATED LEASE CLAUSES tenant's counsel must consider in negotiating exit strategies/representing a prospective buyer –not so silent lease provisions**

**Term--** Obtain a long term lease with options. A five year lease with three five year options gives tenant more flexibility—esp. if business is not working out—if there is only single asset liability, then try for as long an initial term as possible.

**Use clause/Continuous operation**—try to insert specific approved up-front use changes—minimize any elements of new use which would increase the burden on building services—issues re existing exclusives if there is a change in use—

##### **Practice Pointers:**

- note interplay of “go dark” and “continuous use” add: right to close while restaurant biz is up for sale—also during period new owners are making alterations—
- modify clauses that require named tenant to be in actual occupancy
- avoid name specific or band specific limitations in use clause

**Try to be proactive—negotiate upfront certain kinds of changes in use**



**Trade fixtures**—permit financing--veto “Landlord's Lien” language

**Alterations**—add non-structural changes permitted without landlord consent

**End of term**--is tenant obligated to restore premises to “original” condition? That may be a very expensive proposition, esp. as to restaurant installations

**Liability—parties bound**

- Q: is assignor released on transfer? Hard to get, but possible if net worth of transferee meets certain criteria

Try to find specific conditions (substantial net worth of transferee, transferees paying additional security deposit, for example) that will release both the assignor and any lease guarantor

- Example of liability issue: assignee makes alterations that must be removed at end of term—Pointer: try for a clause that says assignor not bound by voluntary acts of assignee/landlord

**OPTIONS-- make sure transferable—esp. in the event of a sale**

**Telecommunications**—rooftop rights

**Guaranties:** -negotiate some limitations in lease guaranties -“Good guy” guarantee

- terminating after a certain number of years without a tenant default
- limited to a certain amount of rent, number of months’ rent or unamortized landlord costs
- also try for a release where there is a creditworthy successor tenant or guarantor

Pointer: An unreleased assignor and guarantor might also want a right to obtain a “new lease” if the landlord terminates the lease and the unreleased assignor and guarantor performs the tenant’s obligations

**Non-disturbance agreement:** try to get it to run to named and any successor tenant--also try to get for a subtenant

The Savvy Restaurateur, presented by Jeffrey A. Margolis, Esq., New York City

*Final Pointer*, If the landlord ever requests any accommodation or amendment related to any lease, try to use it as an opportunity to trim back any Assignment Restrictions in the lease.

Should you wish to discuss any of the above—or anything else of interest--feel free to call

Jeff Margolis

The Margolis Law Firm  
11 East 44<sup>th</sup> Street  
New York, NY 10017

212-490-0900

212-490-0700 (fax)

[jeff@newyorkleaselaw.com](mailto:jeff@newyorkleaselaw.com)

[www.margolislawfirm.com](http://www.margolislawfirm.com)

Thanks for attending the seminar, and Good Luck!