Frankfurt Kurnit Klein + Selz PC

Hospitality Law Newsletter

Opening Your Restaurant: Avoid the “Good Guy Guaranty” Leasing Trap

Chefs and other restaurateurs face myriad legal issues when launching a new eatery. One of the most common legal issues that we see arises from the so-called “Good Guy Guaranty” leasing clause—a widely misunderstood agreement that can create a false sense of security about a restaurant owner’s potential monetary exposure under their real estate lease. (*Note: we use the common industry term 'good guy guaranty' clause in this alert while recognizing it is potentially outdated.*) Below, we identify this trap and outline some steps that aspiring restaurateurs can take to avoid it.

“Location, Location, Location.”

Like other business owners, most hospitality operators understand the old adage that the three keys to real estate are Location, Location and Location. Indeed, substantial market research goes into identifying the optimal place for a new restaurant. Once a general location is selected, brokers and local consultants will show operators a selection of “highly sought-after” spaces that, the operator is told, will be off the market soon. There is enormous pressure to decide quickly. The basic rental terms are stated in a term sheet or letter of intent (i.e. a summary specifying a few key terms, including monthly rent amounts and the dates of the term). In order to keep the upfront security deposit as low as possible, the landlord may request that the operator give a “Good Guy Guaranty”—a form of limited personal guaranty that allows the landlord to reach the guarantor’s personal assets if the tenant fails to pay rent and doesn’t give back the space. This guaranty often appears in a term sheet without any detail as to the guaranty terms. Operators are encouraged to review and sign the term sheet before the landlord will prepare the actual lease and guaranty. A few days later, the hospitality operator receives a lengthy lease and rider, and begins their review of the agreements.

How the Good Guy Guaranty Misleads Hospitality Operators.

At the back of the rider—after many pages of detailed rules and regulations related to paying rent, making alterations, venting the hood, obtaining insurance, and more—the operator discovers the Good Guy Guaranty. Despite its use of the word “good”, operators and their advisors must analyze this clause carefully. It is not a “boilerplate” provision included in most standard lease forms; its specific terms often vary from landlord to landlord, with potentially significant negative impact.

While a Good Guy Guaranty is more limited than a full personal guaranty, it is poorly understood, and therefore can create a false sense of security for the hospitality operator. That’s because brokers and landlords, at the term sheet stage, often describe it as a termination right—falsely assuring the operator that if the business fails, they can just give the keys back to the landlord and the lease will end. Here’s a sample Good Guy provision:

“This **Guaranty shall terminate** and be of no further force and effect as to all matters accruing after the date Tenant vacates and surrenders the Premises to Landlord, provided that (a) Tenant shall give to Landlord not less than **sixty (60) days’ prior written notice** of its intention to vacate the Premises on a date certain (the “Possession Date”), (b) that on or before the Possession Date, **the Premises are surrendered pursuant to the terms of the Lease**, (c) all unpaid Rent shall be paid up to and including the Possession Date…”

The "Good Guy Guaranty" Trap.

The big trap to avoid is the requirement that the surrender of the Premises must be "*pursuant to the terms of the Lease*." What does that mean?

New York courts have found that this requirement is not limited to the physical condition of the space (e.g. broom-clean, vacant, in good repair, etc.), but includes all other surrender requirements stated in the lease (e.g. obtaining landlord's written consent). Thus, returning the space without obtaining the landlord's written consent may not constitute a valid surrender of the premises and, therefore, the guarantor could be liable for the remainder of the rent through the end of the lease term. **In effect, then, depending on how the Good Guy Guaranty clause is drafted, the landlord can retain a veto right over whether or not the tenant can actually surrender the space and exercise the provision**. If the landlord doesn't provide "written consent", the guarantor can be stuck on the lease.

Another thing to notice about the sample provision above is: "This Guaranty shall terminate…" It doesn't say that the **lease** shall terminate; the lease continues, and the tenant is still responsible for all of the rents due under the lease until the end of the lease term. For instance, if the lease is for a 10-year term, and the restaurant fails after year 1, then the tenant remains liable for the remaining 9 years of the term. If the tenant complies with all of the "Good Guy" provisions, then the Good Guy Guarantor (but *not* the tenant) would be released from the remaining 9 years of the term.

Also note that the requirement for the tenant to send 60 days' prior written notice in the sample above is usually negotiable—the shorter the required notice period, the better for the guarantor because from the time that the tenant first sends the notice until the date that the tenant actually surrenders the premises, the guarantor remains liable for the rent. However, New York courts have held that the notice must be timely; if the appropriate amount of notice is not given, then the guarantor remains on the hook. Additionally, if the guaranty requires that the notice be given by FedEx or certified mail but the tenant only sends an email, then the notice is defective, and the guarantor remains on the hook.

Take Four Steps to Avoid The "Good Guy Guaranty" Trap.

Savvy hospitality operators can avoid the Good Guy Guaranty trap by taking these four steps.

1. *Ensure that the requirements for exercising the Good Guy Guaranty are written simply and concisely, and exercisable without any consent by the landlord.* If you can't understand the steps for giving back the space and exercising the Good Guy Guaranty, then ask the landlord to rewrite them. A more operator-friendly guaranty clause may say: "Tenant may exercise the good guy surrender option by leaving the premises in vacant, broom-clean condition and delivering the keys to the Landlord's office. Prior to leaving the premises, Tenant or Guarantor shall give at least 60 days' prior written notice to the Landlord by USPS, UPS or Federal Express. Landlord's consent is not required for Tenant to exercise the good guy surrender option, notwithstanding any contradictory terms in the Lease or this guaranty."

2. *The surrender requirements in the guaranty should be the only requirements.* There should not be any reference to other surrender conditions described in the lease. If there is a reference to any lease conditions, it is best to copy the exact conditions from the lease and paste them into the guaranty so the expectations are clearly stated.

3. *Your term sheet or letter of intent should state the required notice period and conditions to exercising the Good Guy Guaranty*. It is better to negotiate those terms upfront before you spend a lot of time and legal fees reviewing the lease and rider.

4. *If you have to close your business and give back the premises before the end of the term, speak with your attorney beforehand, so that you can review all of the guaranty requirements and exercise the Good Guy Guaranty in the required manner*.

If you have questions about the Good Guy Guaranty Clause, or about any other hospitality leasing issues, please contact Real Estate Group Chair, Larry Welch at (212) 705-4829 or lwelch@fkks.com.

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Recipes for Success: Top Three Considerations for Chefs in the Entertainment Industry

Chefs are expanding their expertise beyond the kitchen to reach wider audiences and explore opportunities in the entertainment industry. As chefs seek to leverage their culinary skills and their personal brand in new ventures, such as television shows, cookbooks, and product lines, this transition comes with its own set of challenges. In this second installment of the Frankfurt Kurnit Hospitality Law Newsletter, we'll discuss the top three considerations chefs should keep in mind as they navigate their success in the spotlight and showcase their talents on a broader stage.

1) Name, Image, and Likeness

Over the years, celebrity chefs have filed lawsuits to address unauthorized use of their names and likenesses and enforce their intellectual property rights. Whether through television appearances or restaurant ventures, a chef's name, image, and likeness serve as essential elements of their brand's identity. Legal protections, such as trademarks, help establish parameters when considering the risks of unauthorized use of their brand. For example, a chef may license their trademark to a kitchenware manufacturer for use on cooking utensils or appliances for a period of time. Similarly for television appearances, negotiating the terms of use and exploitation of a chef's brand in contractual agreements, such as talent agreements, can ensure that the use of their likeness in connection with the series or any endorsements aligns with their brand's image.

2) Protect Your Creations

The 1976 Copyright Act protects "original works of authorship fixed in any tangible medium of expression." However, Section 102(b) of the Copyright Act specifies that copyright does not extend to "any idea, procedure, process, system, method of operation, concept, principle, or discovery." While Copyright law primarily protects creative expressions, such as literary works, art, and music, it presents challenges when it comes to protecting recipes.

So, are recipes copyrightable? Short answer: *It depends*.

While Copyright law does not protect a basic list of ingredients, a recipe that creatively describes or explains a chef's cooking process, along with the list of ingredients, can be protected. Additionally, unique and original recipe compilations, where there is creativity in the selection or presentation of recipes, are eligible for copyright protection as well.

3) Merchandise, Publishing, and Licensing Opportunities

Chefs can often capitalize on their culinary expertise by creating merchandise. In addition, licensing and publishing opportunities allow chefs to authorize third parties to use their brand on various products or services in exchange for compensation. This can include cookbooks, kitchenware, apparel, and more. Taking steps to solidify ownership and trademark their brand provides a chef leverage to negotiate favorable terms, including, for example, royalties and usage rights, in publishing and licensing agreements.

Overall, expanding into the entertainment industry offers chefs exciting opportunities for growth and exposure. These legal protections, which are not an exhaustive list, can help chefs transition into the entertainment industry while safeguarding their brand.

The Frankfurt Kurnit Hospitality Law Group represents many chefs and restaurateurs in their media and entertainment ventures. If you're a chef or restaurateur and you have any questions about how to take advantage of opportunities in the entertainment industry, please contact Marlique Plaisime-Tillman at (212) 991-2033 or mplaisime@fkks.com; Lisa E. Davis at (212) 826-5530 or ldavis@fkks.com; or any other member of the Frankfurt Kurnit Hospitality Law or Entertainment Groups. Read the first installment of the Frankfurt Kurnit Hospitality Law Newsletter here.

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Top Five Legal Considerations for Those New to The Restaurant Industry

Opening a restaurant can be an exciting venture, filled with the promise of creativity, community, and culinary delights. For investors, there is the allure of high returns and a tangible, enjoyable product. However, it's also a business that operates under a complex web of legal regulations with potential pitfalls for restaurateurs and investors alike. To help those new to the industry, we have compiled a list of five key legal considerations to keep in mind when either opening or investing in a restaurant.

1. Choice of Entity and Tax Obligations

Starting a new restaurant is an exciting venture, but it comes with a host of legal and financial considerations. One of the most crucial, initial decisions a restaurateur will make is selecting the right business structure. Each structure has different implications for control, returns, and risk, and the best choice depends on the specific circumstances of the restaurant, including the business goals, the number of owners, and whether the restaurant will require outside investment in the form of equity, loans, and/or convertible debt. Here, we'll briefly explore the most common legal entity structures for new restaurants and the pros and cons of each.

A. Sole Proprietorship

A sole proprietorship is the simplest and most common structure for small businesses. If you're the sole owner of the restaurant, this might be an appealing option.
Pros:

- Easy and inexpensive to establish.
- Complete control over the business.
- Simplified tax reporting.

Cons:

- Unlimited personal liability for business debts and obligations.
- Difficulty raising capital.
- Limited lifespan of the business tied to the owner's life.

B. Partnership

A partnership involves two or more people who agree to share the profits and losses of a business. This can be a good choice if you're starting the restaurant with one or more partners.
Pros:

- Easy to form with a partnership agreement.
- Combined resources and expertise.
- Pass-through taxation (income is reported on partners' personal tax returns).

Cons:

- Joint and several liability for business debts.
- Potential for conflicts between partners.
- Shared profits.

C. Limited Liability Company (LLC)

An LLC is a hybrid structure that offers the liability protection of a corporation with the tax benefits of a partnership. This is a popular choice for new restaurants.

Pros:

- Limited liability protection for owners.
- Flexible management structure.
- Pass-through taxation (or option to be taxed as a corporation).

Cons:

- More expensive to form than a sole proprietorship or partnership.
- Ongoing compliance requirements (filing fees, annual reports).
- Complex operating agreement required.

D. Corporation

Forming a corporation provides the most protection from personal liability, but it also involves more complexity and regulation. There are two main types: C corporations and S corporations.

C Corporation Pros:

- Limited liability protection for shareholders.
- Unlimited number of shareholders.
- Easier to raise capital through the sale of stock.

C Corporation Cons:

- Double taxation (profits taxed at the corporate level and again as shareholder dividends).
- More regulatory requirements and formalities.
- More expensive to establish and maintain.

S Corporation Pros:

- Limited liability protection for shareholders.
- Pass-through taxation (avoids double taxation).
- Potential tax savings on self-employment taxes.

S Corporation Cons:

- Limited to 100 shareholders.
- Shareholders must be U.S. citizens or residents.
- More regulatory requirements than an LLC.

Understanding the restaurant's tax obligations is crucial for financial planning and compliance as restaurants are subject to various taxes, including income tax, sales tax, and payroll tax.

2. Employment Law

Hiring staff brings with it a host of legal obligations. Understand the laws around wages, working hours, overtime, and employee benefits. It is important that restaurant employment practices comply with federal and state labor laws such as minimum wage laws, overtime regulations, and non-discrimination policies. One important aspect of these regulations is the New York tip credit, which enables employers to count a portion of an employee's tips towards meeting the state's minimum wage requirements. A full explanation of these rules is beyond the scope of this alert, please contact your Frankfurt Kurnit attorney to discuss.

3. Lease Agreements

As one of the most expensive fixed costs, it is necessary that a restaurant negotiate a lease agreement that suits its long-term business goals, while remaining realistic about its current state of operations. Close attention to terms related to rent increases, property maintenance, renewal options and "good guy guarantees" is crucial.

4. Intellectual Property

Protecting a restaurant's brand is essential. Consider trademarking the restaurant's name, logo, and any unique menu items to prevent others from using them. Protecting these assets is crucial for maintaining the restaurant's brand identity and competitive edge. Additionally, be mindful of copyright laws when creating marketing materials, menus, and website content.

5. Contracts with Suppliers

Establishing solid relationships with restaurant suppliers is critical for a smooth operation. Ensure that contracts with food and beverage suppliers, equipment vendors, and service providers are clear and detailed, with particular attention to terms related to delivery schedules, payment terms, and quality standards.

Conclusion

Launching a restaurant involves more than just creating a fantastic menu and a welcoming atmosphere. And investing in restaurants requires careful consideration of various legal aspects to ensure a sound and profitable investment. By addressing these five considerations, you will be better prepared to build a successful and legally compliant restaurant business.

If you have questions or seek more detailed guidance on any of these issues, or about any other hospitality issue, please contact Jeffrey Marks at (212) 826 5536 or jmarks@fkks.com, Jonah Brill at (212) 705 4897 or jbrill@fkks.com, or any other member of the Frankfurt Kurnit Hospitality Law Group or Corporate Group. Read the first two installments of the Frankfurt Kurnit Hospitality Law Newsletter here and here.
