RESTAURANT FINANCE MONITOR®

Volume 30, Number 10 • Restaurant Finance Monitor, 2808 Anthony Lane South, Minneapolis, MN 55418 • ISSN #1061-382X

October 17, 2019

## Protect Your Businesses

By Dennis Monroe

One of the concerns that businesses and individuals have is the issue of personal liability. It is really key, if we're looking at downturns in the economy and other ways the restaurant industry may suffer from a loss of revenue and possible store closures. Here are some ideas on limiting the potentially damaging consequences of personal liability:

**1. Cross Collateralization.** The multi-unit operator is often looking to secure an overall financing package. National lenders that deal in the restaurant space, particularly in franchise restaurants, often try to tie up things with a neat little bow. This means all available assets, both business and real estate, are used as collateral for an overall loan. These are two distinct assets and have two potentially different exit strategies and different tax and estate planning attributes. Therefore it is important in financing to keep the real estate assets in separate entities and have the financing stand alone for each entity (limited cross collateralization).

If you achieve limits on cross collateralizing, make sure your inter-company leases are structured to allow termination rights to truly provide for separation.

**2. BADCO.** I've written about this before: The concept is to take assets that are troubled and drop them into a separate entity. Now these can be disregarded entities for tax purposes, so you don't have to file another tax return; but getting those assets segregated may have a real benefit. In many cases, this approach may be problematic for the landlords or lenders and may also create a default once the troubled assets, particularly stores with leases, are moved into separate entities. If you can resolve those issues, creating a BADCO certainly gives you another layer of protection. Even though it doesn't fully protect you, but the possibility of renegotiating leases or loans with stand-alone entities at least creates some bargaining power.

**3. Personal Guaranties on Leases.** Landlords often insist on personal guaranties for leases, but there are techniques to limit the guaranties. First, use a springing guaranty: the guaranty only takes effect if there are two or three late payments in a given year and then lasts for a year or two as long as you don't have any further late payments.

Additionally, you should only look at guaranteeing the leasehold allowances that the landlord has provided, and normally that should burn off in three to five years. Limits of guaranties are essential and need to be actively negotiated, particularly in sale-leaseback transactions, which I'll discuss further in this article.

**4. Use of Separate Entities.** I have been asked many times about the use of separate entities on a store-by-store basis. For many years I thought separate entities were appropriate for each store, but it's really burdensome and it's hard to keep the companies separate, so what I prefer is to have the entities segregated into appropriate classifications, such as by concept or by anticipated performance. Keep those stores you believe are going to be somewhat problematic, even at the time of an acquisition, in separate entities, like BADCOs discussed earlier in this article.

If you think that some stores you're developing may run into troubles, keep those separate, particularly if they are developed in areas that are growing but not quite mature. So multiple entities are very useful.Just make sure that, if possible, your borrowing is to those specific entities and not cross-collateralized.

**5. Franchise Liability.** One of the issues that always comes up is that franchise documents are pretty broad and dragnet in all franchise entities and all individuals as to franchise liability. Make sure to consider your franchise guaranties. Try to segregate your franchise obligations, ideally on an individual franchise location level, but at least by entity.

Also if the franchisor is the landlord or sub-landlord, try and keep those lease liabilities at the store-entity level. Also if you are an experienced operator, definitely try and avoid all personal liability.

**6. Insurance.** Insurance is obviously the key component of risk management, but safety programs, ADA compliance, and certain employee policies like signed waivers of participation in class action lawsuits and mandatory arbitration provisions are also necessary components. Make sure the insurance covers cyber and employee liability, as

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well as the normal property and casualty coverage.

**7. Sale-Leasebacks**. These are effective financing vehicles, however, they come with the risk of a long-term lease. Try to mitigate some of this risk by including buyout provisions, avoiding master leases, maintaining a right of property substitution, the use of multi-entities and elimination, or limitation on personal guaranties. These are all items that need to be negotiated and may result in a slightly higher cap rate, but may be worth it in the long-run.

The legal and financial ideas and techniques suggested above should hopefully help you plan for the present and future. The keys are limitations and segregation.

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