

Monitoring your legal options



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IN THIS TIME OF TOTAL UNCERTAINTY and still no answer as to when Covid will end and when restaurants will go back to full strength, restaurant owners need to know what their legal options are. Many of the ideas I'm presenting here are theories at this point because the courts haven't decided the cases as of yet, but let's look at where we're at in terms of legal rights and legal thoughts.

What are your legal rights as to landlords?

The legal aspects of the restaurant industry that have received the most attention are the landlord/tenant issues. The reasoning behind this is because, except for labor and food, normally your next highest expenditure is rent. There have been many novel legal positions taken as it relates to paying rent, and you should, of course, review your lease with your attorney, but here are some common positions tenants have taken related to paying rent.

- The first one, which hasn't had a huge amount of success, is rent payments can either be reduced or abated entirely because of *force majeure*, which means you aren't able to open or successfully run your restaurant because of acts of god or outside forces. Many leases contain



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a provision that says *force majeure* shall not affect the payment of rent, but even if your lease doesn't, there is still an issue of "does the classic definition of *force majeure* apply to the present situation, particularly closures?" It is still a good argument, but courts at this point have not uniformly granted relief because of *force majeure*.

- I believe your better arguments are two common clauses in your lease. The first is casualty loss. This is loss as a result of some kind of casualty, which according to the definition listed should apply to the pandemic. Again, this is not something that's been universally accepted, but a theory worth pursuing. Basically you are claiming that because of the casualty, your premises have either been partially taken from the casualty or taken in full, or temporarily taken. In all cases, there should be a rent adjustment. The other one that we like is condemnation, which is the provision where the government authority takes part of your

leasehold interest. This normally occurs when there's some kind of construction by the government or they are going to raise a building or something that relates to public taking. We think that the government's positions on either closure or reduction in occupancy come under condemnation. Again, it is still too early to tell what the courts will do, but it is something worth pursuing.

- Other arguments people have tried have been what's known as "impossibility of performance" because of the circumstances outside of the tenant's control. They can't operate, at least at a full capacity.
- One of the most novel—and one I like, but am not sure will work—is if the landlord leases you the restaurant property with the expectation he is leasing you an established customer flow because of other possible tenants also being leased to. An example is a shopping center or mall, where the promise of

lots of customers isn't being fulfilled now because of Covid. Again, something to try.

What are your legal rights as investors?

The rights of investors are almost exclusively provided in the governing legal documents, which govern the relationship between the owners. In most cases, all investors have the right to financial statements, so make sure you are providing your investors with accurate financial statements, which should be based on generally accepted accounting principles (GAAP). Also, there are certain rights that your investors have as it relates to distributions, to pay taxes or other required distributions.

- Make sure that you aren't making distributions if you can't pay your bills in the ordinary course of business (meaning timely), because if you make a distribution and you don't pay your bills, then the recipients of those distributions and possibly the board of directors can be personally liable. Dealing with any money that is distributed out, and any payments made to shareholders, should be looked at carefully to determine that they are fair market value, arms-length and reasonable.
- Also, it may be time to look at a potential buyout of your investors. You should also look at the tax consequences. One of the things to think about in a potential buyout is, can you obtain funding for a buyout, possibly by your investors out on an installment note that starts after Covid is over? Also a buyout may accelerate unused losses for the investor which gives them some economic benefit. You also may want to restructure their investment so it has a floor value but the operator gets a

bigger share of the upside. The most important thing is to understand your documents and your rights.

What should you tell your bank?

A couple of things that are important in this time of Covid are to make sure that you are very transparent with your bank. Let them know what you can and can't afford. Don't go into default without letting them know why. There has been some legislation and some intervening by the government to give banks some latitude in dealing with troubled or non-performing loans. You also may have issues if you received PPP loans or EIDL loans. Be timely filing for forgiveness of your PPP loans and note that you are complying with all of the SBA requirements for the EIDL loans. Again, it is key to be proactive and totally transparent.

One other note, which is sort of an in between note, is that we still are uncertain as to the tax deductibility of the payments made under Covid. If these are not going to be tax deductible, there could be a significant tax burden for the restaurant company. We really don't know for sure. We do know at this point the IRS' position is that they are not deductible, so you'll have to plan for that.


Creditor rights

In most cases, your creditors are going to be your suppliers—food, utilities and services. Again, transparency is key. Don't ignore the overdue amounts. Have a plan for post-Covid and communicate that plan to the suppliers. If you have any cash, you may get discounts for quick pay or payment on delivery, which may be beneficial from a business standpoint, but make sure that you are assessing all of your supplier relationships. I have heard of some people changing their broadline vendors

to get away from overdue amounts. That is probably short-sighted. The best thing to do is have a vendor that is cooperative and understands your situation and gives you some leeway. In most cases, they are also in a world of hurt, so maybe there is a joint solution.

Employee rights

The final legal right that you need to understand is your relationship with your employees. First off, the one key principle is that you have to protect your employees (as well as your customers) from getting Covid at your establishment, so make sure you are completely following the CDC guidelines. That seems to be a safe harbor for avoiding some liability, and also Congress is looking at tort reform to help employers with their potential claims from employees of unsafe work environments. You certainly don't want to go the route of unsafe. You want to ensure you're providing a strong, safe environment.

Additionally, make sure you are complying with all of the local rules concerning paid leave as it relates to contracting Covid. If it is a non-frontline job, allow them to work off site as much as possible. The key is to create an environment that has both the perception and reality of being safe. All of the withholding and employee share of FICA should be paid in a timely manner to the government because personal liability is created if you don't pay those fees. Make sure that the issue of gratuity and service charges are handled correctly, so there are no claims by employees. Be proactive. 

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