



APRIL 23, 2020

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Ghost Kitchens

I. INTRODUCTION

The introduction of meal delivery apps including UberEats, GrubHub and DoorDash expanded e-commerce in the food industry and increased the size of the food delivery market.¹ Over the last five years prior to the start of 2020, the delivery market had grown 300% faster than the dine-in market.² As the delivery market continues to expand, restaurants and brands are struggling to keep up with the volume of orders and address margin challenges caused by rising rents and delivery service fees. Food delivery is often expensive for restaurants as delivery and packaging fees take a big cut of restaurant profits.³ As a solution, restaurants are investing in off-premises locations, sometimes known as “ghost kitchens,” to reduce real estate and staffing costs. Initially, ghost kitchens were used by small and midsize restaurants to build brand awareness using a lower overhead model. However, as the on-line food industry continues to climb from \$18 billion in revenue in 2019 to a projected \$24 billion by 2023, larger brands are opening up their own ghost kitchens to compete with the increasing delivery demand, to enter new markets and to test consumer demand.⁴ Further, given the current COVID-19 pandemic, many restaurants are developing and expanding their delivery services out of necessity as many restaurants are required to close dine-in options.

II. OVERVIEW OF GHOST KITCHENS

Ghost kitchens, also referred to as dark kitchens, blackbox kitchens, cloud kitchens and virtual kitchens, are food production spaces that do not have a storefront or a dining area and are mainly used for delivery and/or catering. These ghost kitchens are popping up in empty retail space, parking lots, and in underdeveloped or undesirable locations.⁵ Ghost kitchens alleviate margin challenges for restaurants as they require an initial lower investment and overhead and can be optimized for delivery. The major benefits include (1) minimizing real estate and labor costs and (2) limiting premises liability as only kitchen staff and delivery providers are on-site. Venture capital investment in ghost kitchens has risen since 2016, with deal values increasing by 2.4 times during such period and with \$1.9 billion in 2019 across 16 deals.⁶



III. FORMS OF GHOST KITCHENS

a. Commissary Kitchens

Commissary kitchens have been the most common form of ghost kitchen. These are shared kitchen spaces that are often owned and operated by third parties rather than a single restaurant. At times, these kitchens have several restaurants or brands operating out of the same location, often sharing fridge and storage space. As these kitchen spaces are shared, it is important that the underlying lease and other business agreements clearly allocate regulatory and other responsibilities since multiple entities will be utilizing and managing the space. Also, entities using these spaces should consider utilization of non-competes and trade-secret protections if the spaces are being utilized by competitors. The appropriate allocation of responsibility and non-compete / trade secret protections will vary depending on the particular facts and circumstances at issue.

Third-party delivery platforms, including DoorDash and Kitchen United, have opened shared ghost kitchens that utilize their delivery software.⁷ Restaurants can lease space in the kitchen and reach their customers through the company's software. DoorDash maintains the facility and handles the logistics of delivery and in exchange charges a percentage of each brand's gross sales as a rental fee for kitchen space. Kitchen United charges a monthly fee and a percentage of every order on the delivery platform, which also covers services such as dishwashing, food receiving and cold storage.⁸

Startups, including Cloud Kitchens and PREP, provide shared kitchen space but do not provide delivery software and allow restaurants to utilize all major online food ordering platforms. PREP charges a membership fee for use of the facility on an hourly basis and Cloud Kitchens charges a rental fee for use of the space.

b. Independent Ghost Kitchen

Independent ghost kitchens are off-premises locations leased by a single restaurant or brand. Rather than rent from a third party, certain major restaurant brands, including The Halal Guys and Sweetgreen, are moving delivery and catering services offsite.⁹ Halal Guys is currently working with Fransmart, a franchise development company, to develop 400 new ghost kitchens to expand its delivery service. Halal Guys has negotiated contracts with third party delivery services as well as its own mobile app for delivery from the independent ghost kitchens.¹⁰

In addition to restaurant brands, grocery stores and multi-branded restaurant companies are also utilizing independent ghost kitchens. Kroger has partnered with ClusterTruck, a ghost kitchen software platform, to offer meal delivery from central kitchens¹¹ and Inspire Brands is actively looking into ghost kitchens.¹²

IV. FOOD SAFETY LEGAL/REGULATORY CONSIDERATIONS

Ghost kitchens are subject to a host of federal and state food safety requirements. The specific nature and breadth of those requirements depend, in part, on whether the ghost kitchen is required to register with the U.S. Food and Drug Administration ("FDA") as a "food facility." As a general matter, facilities that manufacture, process, pack, or hold food for consumption in the United States must be registered with the FDA.¹³ Certain types of facilities, including those meeting the definition of a "restaurant" or "retail food establishment," are exempt from this registration requirement.

The FDA defines a "restaurant" to mean "a facility that prepares and sells food directly to consumers for immediate consumption. 'Restaurant' does not include facilities that provide food to interstate conveyances, central kitchens, and other similar facilities that do not prepare and serve food directly to consumers."¹⁴ Restaurants include, for example, cafeterias, cafes, quick-service establishments, and catering facilities. The FDA has indicated in guidance that central kitchens that prepare food for a chain of restaurants do not qualify as "restaurants" since they do not sell the food they prepare directly to consumers for individual consumption.¹⁵



Meanwhile, the FDA defines a “*retail food establishment*” as an establishment that sells food products (including those that it manufactures, processes, packs or holds) “*directly to consumers as its primary function.*”¹⁶ A retail food establishment’s primary function is to sell food directly to consumers “*if the annual monetary value of sales of food products directly to consumers exceeds the annual monetary value of sales of food products to all other buyers.*”¹⁷ The term “*consumers*” does not include businesses.

Ghost kitchens that are required to be registered with the FDA are subject to routine FDA inspection and a number of federal food safety requirements under the FDA Food Safety Modernization Act (“FSMA”). These include, for example, compliance with the FDA’s updated current good manufacturing practices (“cGMPs”) for food, hazard analysis and preventive controls requirements, and food defense/protection from intentional adulteration requirements. Ghost kitchens that are exempt from FDA registration are primarily regulated and inspected by state and local health authorities and required to comply with applicable state “food codes.” These food codes cover requirements related to employee health and hygiene, sanitation, temperature control, hazard analysis and critical controls points, etc.

Based on their specific activities, ghost kitchens (whether FDA-registered or not) could also be subject to certain other FDA requirements. For example, ghost kitchens that are shippers, carriers, or receivers of food are subject to FDA requirements for the sanitary transportation of food. Similarly, ghost kitchens that directly import food from overseas would be subject to the FDA’s foreign supplier verification program (“FSVP”), which requires importers of food to evaluate their foreign suppliers’ food safety protocols and maintain a host of required documentation. The allocation of these responsibilities will generally be a contract matter to be negotiated.

Finally, although many ghost kitchens that process meat and poultry products are exempt from continuous inspection by the United States Department of Agriculture’s (“USDA”) Food Safety and Inspection Service (“FSIS”), it is imperative that all ghost kitchens carefully evaluate USDA’s definitions of “retail store,” “restaurant,” “restaurant central kitchen facility,” and “caterer” to confirm that their specific operations and activities are exempt.

Failure to comply with applicable food safety requirements is not only unlawful but exposes companies operating ghost kitchens to significant potential liability. For example, food safety failures can lead to product recalls and foodborne illness outbreaks. Due to developments in human genome sequencing, the FDA, the Centers for Disease Control and Prevention (“CDC”) and state health authorities are better able to identify national outbreaks and even link specific consumer illnesses to a specific food commodity or restaurant. Foodborne illness outbreaks can result in negative publicity, product liability lawsuits, and temporary (or even permanent) shut down of the establishment that produced the contaminated item. It is thus imperative for: (1) all ghost kitchens to have stringent food safety procedures in place; and (2) companies using commissary ghost kitchens to verify that the owners (and other users) of such kitchens are operating in compliance with applicable state and federal food handling and production requirements. The potential for comingling food products with other brands in the same space and for cross-contamination of food products makes it essential that contracts covering allocation of these risks and responsibilities (i.e., cleaning and sanitation, inventory control, employee hygiene, etc.) are carefully and thoughtfully negotiated.

V. IMPLICATIONS OF COVID-19 ON THE BURGEONING GHOST KITCHEN INDUSTRY

The recent COVID-19 pandemic is far reaching on many industries and economics as a whole. The long-term effects of the disease on the ghost kitchen business model is unknown. However, many restaurant and food delivery participants may look to ghost kitchens during this time as an attractive alternative as the move to a more delivery-centric model is accelerated. It is also possible that this crisis could result in the ghost kitchen model experiencing an up-tick in growth as the restaurant industry begins to develop more sustainable delivery models in the future.



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¹ Heath Haddon, *Latest Front in Food Delivery: Kitchens in Empty Malls*, WALL ST. J. (Feb. 2, 2020), <https://www.wsj.com/articles/latest-front-in-food-delivery-kitchens-in-empty-malls-11580644801>; Konrad Putzier, *E-Commerce Turns the Tables on Restaurant Space*, WALL ST. J. (July 2, 2019), https://www.wsj.com/articles/e-commerce-turns-the-tables-on-restaurant-space-11562072400?mod=article_inline.

² Stephanie Resendes, *22 Online Ordering Statistics Every Restaurateur Should Know in 2020*, UPSERVE (Jan. 20, 2020), <https://upserve.com/restaurant-insider/online-ordering-statistics/>.

³ Heather Haddon & Julie Jargon, *Consumers Love Food Delivery, Restaurants and Grocers Hate It.*, WALL ST. J. (Mar. 9, 2019) <https://www.wsj.com/articles/consumers-love-food-delivery-restaurants-and-grocers-hate-it-11552107610?mg=prod/com-wsj>.

⁴ Julie Littman, *Why the Delivery Market will Look Different in 5 Years*, RESTAURANT DIVE (Jan. 28, 2019) <https://www.restaurantdive.com/news/why-the-delivery-market-will-look-different-in-5-years/546936/>; Lauren Stine, *Inspire Brands Explores Ghost Kitchens*, RESTAURANT DIVE (Feb. 19, 2020) <https://www.restaurantdive.com/news/inspire-brands-explores-ghost-kitchens/572534/>; Maggie Hennessy, *Are Ghost Kitchens the Future*, QSR (July 2019) <https://www.qsrmagazine.com/technology/are-ghost-kitchens-future>.

⁵ Haddon, *supra* note 1.

⁶ Alex Frederick & Aria Nikkhoui, *The Burgeoning Ghost Kitchen Industry*, PITCHBOOK (Mar. 17, 2020) https://files.pitchbook.com/website/files/pdf/PitchBook_Q1_2020_Analyst_Note_The_Burgeoning_Ghost_Kitchen_Industry.pdf.

⁷ Peter Romeo, *DoorDash Opens a Ghost Kitchen*, RESTAURANT BUSINESS (Oct. 14, 2019), <https://www.restaurantbusinessonline.com/operations/door-dash-opens-ghost-kitchen>.

⁸ Hennessy, *supra* note 4.

⁹ Jonathan Maze, *Chick-Fil-A Opening a New Delivery Focused Prototype*, RESTAURANT BUSINESS (Oct. 9, 2019), <https://www.restaurantbusinessonline.com/financing/chick-fil-opening-new-delivery-focused-prototype>.

¹⁰ Jennifer Marston, *The Halal Guys is Aggressively Expanding Its Ghost Kitchen Strategy for Franchisees*, THE SPOON (Jan. 22, 2020) <https://thespoon.tech/the-halal-guys-is-aggressively-expanding-its-ghost-kitchen-strategy-for-franchisees/>.

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¹² Jonathan Maze, *Arby's Owner is Considering Ghost Kitchens*, RESTAURANT BUSINESS (Feb. 18, 2020) <https://www.restaurantbusinessonline.com/financing/arbys-owner-considering-ghost-kitchens>.

¹³ 21 C.F.R. § 1.225 (2019).

¹⁴ 21 C.F.R. § 1.227 (2019).

¹⁵ U.S. FOOD & DRUG ADMIN., GUIDANCE DOCUMENT, QUESTIONS AND ANSWERS REGARDING FOOD FACILITY REGISTRATION (SEVENTH EDITION): GUIDANCE FOR INDUSTRY at 18 (Aug. 2018), <https://www.fda.gov/media/85043/download>.

¹⁶ 21 C.F.R. § 1.227.

¹⁷ *Id.*