

Exclusive Use Clauses in Shopping Center Leases

By **Randall S. Arndt**

There are few shopping center lease clauses that are more important to a retail tenant than the exclusive use clause. For many retail tenants, the scope of the exclusive use clause represents the essence of the tenant's bargain with the landlord. A tenant's ability to "corner the market" in a retail center for its particular use adds tremendous value to the leasehold estate and can significantly expand the tenant's gross sales at the center.

BARGAINING STRENGTH

The earlier the prospective tenant ("Prospect") can negotiate the scope of its exclusive use rights in the center, the better off the tenant will be. A Prospect should negotiate its exclusive use rights and any exceptions thereto as part of the letter of intent. A Prospect's ability to negotiate a broad exclusive right is in large part a measure of the bargaining strength of the Prospect. Many factors must be considered when assessing the Prospect's bargaining strength, including the size of the leased premises, the desirability of the Prospect, the desirability of the particular use, the financial strength of the Prospect and the reality of the marketplace.

In assessing a Prospect's ability to negotiate an exclusive use right, one size does not fit all. For example, a 5000 square foot retail shoe store may not command sufficient size in a center to warrant an exclusive use for the sale of shoes, depending on the size of the center. Each particular use must be analyzed in light of the size of the proposed leased premises and the size of

the center. A Prospect with a strong national or regional reputation, which is viewed as a strong draw for customers, will be more appealing to the landlord than a tenant without a strong reputation. Consequently, the landlord will be more inclined to grant the exclusive use rights to the well-known Prospect. Similarly, if a landlord feels that a particular type of use will complement its tenant mix in the center, it may be more likely to grant exclusive use rights to land the Prospect for its center.

A Prospect with a strong balance sheet also has a greater chance of negotiating an exclusive use right. Prospects that are strong financially are always more appealing to a landlord and command more leverage in negotiations. Additionally, the reality of the marketplace frequently dictates whether a Prospect commands exclusive use rights. Prospects desire to go into popular centers where there is strong customer traffic and a complementary tenant mix. If there is a lack of good options for a Prospect to locate its business, it may be more willing to locate in a center without a full exclusive than in a less desirable center where a strong exclusive use clause can be negotiated.

DUE DILIGENCE

Sophisticated Prospects ask questions regarding existing exclusive use rights in the center and regarding use rights of existing tenants that can infringe upon a Prospect's desired exclusive for a particular use. It is not sufficient for the shoe retailer to ask who else sells shoes and footwear in the center if that Prospect desires an exclusive on the sale of shoes and

footwear. A savvy Prospect will ask for a list of all existing exclusives as well as a list of those tenants with broad use rights. Many big box and anchor tenants have broad use rights, such as "any lawful retail use" and are therefore potential competitors of the Prospect. Some Prospects may take comfort in the fact that it is unlikely that the use of a 75,000 square foot anchor store will be converted to the sale of the primary item sold by that Prospect. In many respects this is the reality of going to a center with large anchor spaces. The large anchor will likely negotiate broad use rights regardless of exclusives previously or subsequently granted to other tenants in the center, and the smaller tenant will likely have to live with the potential consequences of those broad use rights. A big box could be divided into a number of different stores, any one of which might end up competing directly with that Prospect. The Prospect has to weigh the benefit of being in a center with strong anchor tenants against the potential that the anchor(s) may wind up competing with the Prospect.

The Prospect should assess what sites in the center are controlled by the landlord and the extent of that control. There are several questions the Prospect should ask: Have outlots been sold? Does the landlord have any control over the use of those outlots? Do the anchor tenants own or control their pad sites (this would diminish any type of control the landlord may have over a change of use of the stores located on the anchor pads)? Are there reciprocal easement agreements that protect exclusive use rights of tenants

coming into a center?

A Prospect is wise to spend considerable time assessing the existing competition, the potential competition and the landlord's ability to impact existing and future competition so that the Prospect can maximize its gross sales in the center.

If a Prospect assesses the scope of existing tenant use rights and discovers that there are existing tenants directly utilizing their space for the same use over which the Prospect desires to have an exclusive in the center, or that there are tenants with broad use rights that have the potential to be competitors with the Prospect, there are many things that the Prospect can do to try to minimize that competition. Where a landlord has consent rights as to an existing tenant's assignment or subletting or change of use, a Prospect that is desirable to a landlord may have sufficient leverage to get some concessions from the landlord. For example, the landlord may agree that, upon a request by a tenant for consent to an assignment, subletting or change of use, it would condition its consent to the request upon the tenant's agreeing to recognize the exclusive use rights of the Prospect. To illustrate: An anchor tenant may have a use clause providing for any lawful retail use, subject to exclusives in effect when the anchor came into the center. If the landlord has consent rights, upon a proposed assignment of the anchor tenant's leasehold estate, the Prospect should require the landlord to agree to condition its consent to an assignment by the anchor tenant to that tenant agreeing, at the time of the assignment, that such leasehold shall thereafter be subject to the exclusive use provisions of the Prospect.

Many landlords will be concerned that an existing tenant may contest the landlord's right to condition its consent on agreeing to recognize the Prospect's exclusive use provision. The Prospect can try to accommodate the landlord's concern by agreeing that if a court determines that it is unreasonable for the landlord to so condition its consent, the landlord would be released from its obligation to so condition its consent. A

landlord may be willing to take the risk of litigation over such an obligation for the right tenant.

The Prospect should also assess whether its exclusive will be absolute or subject to certain exceptions. For many retailers, having an exclusive on the primary use of the sale of a certain item or items is satisfactory. This works for many retailers selling a variety of goods. However, in the case of certain retailers, like the retailer selling shoes and footwear, having the primary use exclusive for the sale of shoes and footwear in a center is most likely insufficient. If a retailer utilizes 20,000 square feet for the sale of shoes, another retailer may come into the center and lease 40,000 square feet, utilizing 14,000 square feet for the sale of shoes. Such sales might not constitute its "primary" use in all scenarios. Accordingly, the Prospect may try to limit the sale of shoes and footwear by other retailers to the "incidental use" thereof. The incidental use definition varies depending on the size of the various stores in the center. For instance, a definition of incidental sales as 10% or less of the sales floor area may be meaningful in most scenarios. An anchor tenant that leases 75,000 square feet and utilizes 10% of its selling area for the sale of shoes and footwear could be utilizing 7500 square feet for shoe sales — which would be a lot of competition for the Prospect selling shoes. In order to protect the Prospect, incidental sales should be defined as the lesser of (i) x square feet of space, and (ii) y percent of such other retailer's premises.

SPRINGING EXCLUSIVE

Some landlords take the position that their centers will be free of all exclusives as no tenant in the center will receive an exclusive for any particular use right. In many cases this defies the logic of the marketplace. Many retailers will simply refuse to go into a center without some type of an exclusive. To protect itself against a scenario where a landlord represents no exclusives will be granted but thereafter grants one or more exclusives to induce tenants to its center, a Prospect should insist on a springing exclusive clause providing that in the event the landlord grants an exclusive at any time to any other ten-

ant, then the Prospect will receive an exclusive retroactive to the date of its lease for the use it desires to protect. The protected use must be spelled out with clarity.

Using our example above, the shoe store would receive an exclusive for the sale of shoes and footwear in the center retroactive to the date of its lease in the event the landlord subsequently grants an exclusive to any other tenant in the center. This language needs to be coupled with representations and warranties by the landlord that there are no existing exclusives in effect as of the date of execution of the lease. Together with the representations and warranties, the retroactive springing exclusive would then protect the Prospect from any exclusive granted subsequent to the date of its lease.

EXCLUSIVE VIOLATIONS

A strong exclusive does not offer much protection unless it is coupled with strong remedies in the event of a violation thereof. Most landlords will distinguish between a violation by a "rogue" tenant (*ie*, a tenant violating the terms of its lease in breaching the exclusive granted to another party) and a violation of an exclusive on account of the failure of the landlord to prohibit a tenant from selling goods for which the landlord has previously granted an exclusive to another tenant. This breach may be on account of the negligence of the landlord; in other cases it may be on account of the landlord not wanting to let a hot Prospect slip through its fingers notwithstanding an existing exclusive. An existing lease may have been in effect for many years, the rent may be significantly below market, and the landlord may be willing to breach the previously granted exclusive intentionally by bringing in another tenant willing to pay a much higher rent in order to be in the center. A tenant should require the landlord to act with due diligence and in good faith to cause any violation of its exclusive to terminate immediately. A landlord should be compelled to try to obtain a temporary injunction and pursue such other remedies as are available in order to cause any violation to terminate. A tenant should also be entitled to strong financial relief in the event

of a violation of its exclusive. This would include an immediate reduction in rent. Some Prospects insist on an abatement of all base rent in the event of a violation of its exclusive. Some revert to percentage rent only. The financial remedies are numerous. In addition, a Prospect should insist on a termination right in the event the breach is not cured within a specific period of time.

A Prospect should be more sympathetic to a landlord who is acting in good faith to facilitate a cure of the breach by a rogue tenant. With a non-rogue tenant violation, such as a willful breach by the landlord or the landlord's failure to prohibit a new tenant from honoring previously granted exclusives, tenants should have little compassion for the landlord and should insist on immediate relief. A violation not terminated within a certain amount

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of time should give the tenant whose exclusive has been violated the right to terminate the lease, in addition to other available rights and remedies. Nothing short of a termination right may get the landlord's attention in many instances. A termination right will certainly get a lender's attention. This is a severe remedy, but one that strong Prospects will argue is most appropriate in light of the critical nature of the exclusive use provision and the resulting consequences of a breach thereof.

From the tenant's prospective, the damages incurred on account of a breach of its exclusive are immeasurable. No calculation of damages when negotiating the lease is likely to provide full and appropriate relief to the tenant. Nevertheless, a landlord will strongly insist that a tenant cap its reduced rent period and be compelled either to return to full rent or terminate its lease after a certain amount of time. The tenant should strongly resist this provision where a landlord intentionally violates a tenant's exclusive by granting similar use rights to another tenant. In the event of a rogue tenant where a court refuses to enforce exclusive use rights, a landlord has a strong argument that the tenant should return to full payment of rent or terminate. In any other circumstance, tenants should not be sympathetic to the landlord's predicament. The essence of

the tenant's bargain, its exclusive use rights, has been violated, and the tenant needs severe and drastic remedies on account thereof.

CONCLUSION

A prudent Prospect must spend considerable time assessing the benefits of locating in any particular center. Part of that process is determining the extent of the Prospect's potential exclusive use rights and the rights of existing tenants and existing leasehold interests in conflict with that use. These issues need to be addressed in great detail in a lease. Existing tenant exclusive use clauses should be a lease exhibit. An incoming tenant must assess whether those competing use rights run to particular parties or run to the entire leasehold interest and whether the landlord can minimize the risk of competition by granting conditional consent provisions to the incoming tenant. Once the Prospect negotiates a strong exclusive use right, the Prospect must be equally diligent in negotiating remedies in the event of a violation. Both are required in order to protect one of the most important rights a tenant obtains in negotiating a shopping center lease.

