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From Billy Idol to Billie Eilish: Repurposing a 1980s Shopping Center

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This article explores the current state of the retail market, as impacted by COVID-19, and the challenges faced by developers/landlords as they redevelop 1980s shopping centers from simply being places to spend "Mony Mony" to being mixed-use developments that include "everything i wanted" (yes, these are titles of Billy Idol and Billie Eilish songs).

Current State of Retail Real Estate: A Landlord's Perspective

The success or failure of the retail real estate sector is an issue that permeates the entire economy and impacts everyone, not just retail real estate investors. The retail sector is one of the largest employment generators in the United States and the real estate taxes generated by shopping centers are instrumental in funding a large percentage of municipal tax bases across the country.

These are dark times for the retail real estate business. Retailers are fighting for their very existence, and in many cases, that fight will not end well. The retail industry, at least in certain segments, was already facing significant headwinds, all of which were accelerated by COVID-19. In 2019 (pre-pandemic), a record 9,879 retail stores closed in the United States. (Source: https://www.forbes.com/sites/walterloeb/2020/07/06/9274-stores-are-closing-in-2020--its-the-pandemic-and-high-debt--more-will-close/#7f4cd537729f) In 2020, 12,200 retail stores permanently closed. (Source: https://fortune.com/2021/01/07/record-store-closings-bankruptcy-2020/) Likewise, landlords are reeling from an enormous drop in rent collections, store closures and tenant abandonment, not to mention tenant lawsuits to abate rent or, in some cases, terminate their leases. Looking ahead, landlords will face myriad issues created by the short and long term loss of rent, visible vacancies detracting from the shopping experience, co-tenancy claims, and lenders/investors that will eventually run out of patience.

The retail industry has been under pressure for so long that Americans have become somewhat desensitized to announcements of bankruptcies and/or liquidations of storied brands (such as Sears, J.C. Penney, Brooks Brothers, Lord & Taylor, Toys "R" Us, among many others). There is definitely something sad about the demise of a brand that you grew up with, whether shopping for back-to-school clothes as a kid, reading every page of the holiday catalog and circling the toys you hoped to receive, buying your first business suit for a job interview, or just experiencing the look, feel and smell of certain stores when you walked through the mall as teenager. It should be noted that not every retailer bankruptcy brings an end to a brand; often retailers use Chapter 11 of the U.S. Bankruptcy Code (11 U.S.C. § 101, *et seq.*) as a mechanism to allow for reorganization of debt, shedding

unprofitable stores through lease rejection (Section 365 of the Bankruptcy Code enables bankrupt tenants to assume or reject leases, subject to certain requirements and landlord rights) and renegotiating assumed leases with landlords. Even for retailers that are liquidated in bankruptcy, value in the brand may remain and the intellectual property can be sold and re-used. Authentic Brands Group has been very active in purchasing such intellectual property; it currently owns more than 50 consumer brands (everything from Aeropostale to Forever 21 to Juicy Couture). In 2020, Authentic and Simon Property Group purchased Brooks Brothers and agreed to continue to operate 125 of the 424 Brooks Brothers retail stores that were open before the pandemic.

While the rise of e-commerce and online shopping has played a role in the demise of certain retailers and retail segments, the pre-COVID-19 statistics do not support the anecdotal stories of the end of bricks and mortar retail. In 2019, only 11% of retail sales occurred online. (Source: https://www.cnbc.com/2020/10/14/beyond-amazon-prime-day-4-ways-e-commerce-has-shaken-up-retail-.html) Certain segments of the retail industry (such as books, electronics, and fashion retail) are more susceptible to online competition than others and have naturally struggled more. That said, some traditional brick and mortar retailers have faced the challenge head-on and have pivoted successfully to omnichannel business models that include both traditional in-store sales and on-line sales and other options such as curbside pickup, same day delivery, and in-store price matching of online competitors. Best Buy is a great example of a retailer who faced the online sales challenge head-on and was able to pivot in a way that was somewhat surprising to industry experts. Pre-COVID-19, the demise of individual retailers could often be explained by poor merchandising or operations, losing touch with consumers, and most notably the extreme burden of debt taken on by private equity acquisitions and recapitalizations. When COVID-19 started to significantly spread in the United States in March 2020, within in a matter of weeks most of brick and mortar retail and restaurants were completely shut down and continued to be materially restricted for most of 2020. Such closures and restrictions proved difficult to survive, even for strong and well-capitalized brands.

COVID-19 accelerated the consumer shift to buying more goods and services online by a number of years, really out of necessity. For many months during 2020, in-store shopping was simply not possible, and in many cases prohibited by government mandate. Essential retailers (e.g., grocers, home improvement, pharmacy, etc.) thrived, and stores with strong existing online platforms performed well, but retailers that were dependent on in-store sales have struggled. To be sure, there is pent-up demand for the American consumer to return to normalcy, to go places, to be entertained and, yes, to shop. When Americans feel safe being in crowds (perhaps after we achieve herd immunity), it can be assumed that they will return in droves for that quintessential American consumer experience. However, to a large degree, the damage has already been done. People have become more comfortable buying goods and services online and have found it relatively easy to do so. The length of the pandemic has had a lasting impact on consumer behavior. It is now anticipated that 14.4% of retail sales will be online in 2020 and that the number will climb to 19.2% by 2024. (Source: https://www.cnbc.com/2020/10/14/beyond-amazon-prime-day-4-ways-e-commerce-has-shaken-up-retail-.html)

To make matters worse, the retail landscape had already been shifting for years from a traditional shopping experience to a more "experiential" environment dominated by restaurant and entertainment venues, movie theaters, trampoline parks, virtual reality experiences, fitness centers, etc., that are all centered around close personal interaction. This shift compounded the impact of COVID-19 on the financial success of retail centers during the pandemic. Pre-pandemic, a shift toward experiential retail and mixed-use centers was seen as the saving grace for retail.

Will such a shift still save retail centers? While developers have certainly been rethinking some elements of their converted mixed-use centers (e.g., developers are likely wary about focusing too much on office and hotel uses given some of the challenges the pandemic posed for those asset classes), some developers are still determined to convert their tired 1980s-era malls into places to shop, work and play. In order to do so, they need to think carefully about consent rights, co-tenancy provisions, and other provisions in reciprocal easement agreements (or similar documents, commonly referred to as "REAs"), leases and loan documents that may impact their right to make changes to the shopping center.

REA Provisions, Leases and Loans Documents: Consent Requirements

1. Parties with Consent Rights

A major factor that impedes retail real estate owners' ability to pivot and redevelop their properties is the numerous third party consent rights under contractual arrangements, namely consent rights in favor of (1) owners of other parts of the shopping center under REAs, (2) strong tenants under their leases (historically, only large anchor store leases included tenant consent rights with respect to redevelopment matters, but over time other smaller sized national retailers have bargained for greater consent rights as well) and (3) lenders under loan documents. To those outside of the inner workings of the retail real estate business, the number of other parties in the shopping center ecosystem who must consent in order for the landlord/developer to redevelop the property likely seems preposterous. This issue is highly unique to the retail industry. In other sectors such as office, industrial, multifamily, etc., the tenants and neighboring property owners have far fewer consent rights over what the developer/landlord can do. In some respects, this makes sense because the retail experience is so symbiotic and interrelated. In an office building, the success of one tenant has virtually no effect on the success of another. In a shopping center, in contrast, being close to other highly successful operators can drive tremendous business to other nearby retailers (thus the desire for co-tenancy provisions, discussed in detail below).

2. Consent Rights Generally

Typically, at the outset of a redevelopment project, the developer/landlord starts by analyzing all of REAs, leases and loan documents to determine which parties would have consent rights over the various options the developer/landlord is contemplating for redevelopment. The process of identifying and seeking all the necessary consents can takes months and years and can be extremely costly. To compound this issue, many retailers have realized that their consent rights can be monetized and even weaponized. There can be great power in being a hold-out with legal rights to stop or impede a project that would potentially create significant value. This has become such an issue that some struggling retailers have made withholding their consent to redevelopment part of their business model. This was certainly not the intent of the original parties when the REA regimes and anchor leases were established. It is understandable, even if frustrating to developers/landlords, for REA parties and certain anchor retailers to have consent rights over matters that would truly have an adverse impact on them, but somewhere along the way, the line has blurred and developers/landlords are sometimes blocked or extorted for significant sums of money (or horse-traded for rights or benefits at other properties if there is a portfolio relationship between the landlord and retailer), in a manner not anticipated when the REA regimes and anchor leases were executed.

As developers continue to seek new ways (both with alternative uses and common area initiatives) to bring life back to regional malls and other dated shopping centers, a topic on any developer or tenant's mind should be provisions requiring consent for a landlord to redevelop a shopping center. This is important to all parties involved and each will try to protect its own interests: the tenant by requiring the landlord to seek consent for any new buildings, improvements or other changes to the site plan within defined critical areas, while the landlord will seek to minimize both the scope of such consent rights and the liquidated damages associated with a violation of any such restriction.

3. Prohibited Uses

The consent rights of other stakeholders at a shopping center may relate to a host of issues that are impacted by a proposed redevelopment. Many REAs that govern the operation of shopping centers are decades old and from a time where the parties envisioned a very specific shopping experience. Accordingly, there are often long lists of prohibited uses that were generally designed to (a) avoid unsavory or noxious uses (e.g., nightclubs, x-rated movie parlors, bars, massage parlors), (b) uses that are incompatible with the historic notion of retail (e.g., apartments, hotels, industrial uses, schools or training facilities, healthcare offices), and (c) uses that have a particularly intense use of parking without enhancing the overall shopping activity at the property (e.g., theatres, fitness centers, even grocery stores). These use restrictions are very often antiquated and do not allow for a transformation of a shopping center into a vibrant mixed-use community, even if that would objectively be better for all parties.

4. Site Plan Controls

In addition to the use restrictions affecting the shopping center, REA parties and tenants often have consent rights that impact the physical nature of the property. These include restrictions on de-malling a property, building outside of certain defined building areas, closing off interior entrances to anchor stores, reconfiguring the common areas or parking lots, height restrictions, visibility protections, stringent signage requirements, and the list goes on.

Site plan controls may include, among other things, no-build areas, requirements to maintain identified access ways and drives open throughout the lease term, and parking area limitations. In addition to those restrictions, national and regional retailers will often seek to impose limitations on the office, residential and other non-retail uses that have become increasingly more desirable for landlords in shopping center redevelopments.

No-build areas include areas where the landlord agrees not to permit a new structure, building or other improvement without first getting tenant approval. The tenant will want to negotiate the size of these areas if they have a concern over adequate parking space for customers. Tenants may be concerned with visibility corridor or height restrictions if a proposed construction blocks the view of the tenant's building from the road or other areas where customers are present. A landlord will want to minimize the no-build area to avoid seeking consent and possibly being denied consent to redevelop and add structures as needed. Often, negotiations will include carve-out provisions for smaller items, such as cart corrals, landscaping and benches, and for improvements required to comply with applicable laws. To the extent the tenant requires the extension of the no-build area to an adjacent tract or parcel that is not owned or controlled by the landlord, that approach is workable for both parties, but the landlord will want to ensure it is protected with respect to construction on such portion of the no-build area that occurs outside of landlord's control. Here's an example of a negotiated No-Build Area provision with such carve-outs:

> *Except as required to comply with any Applicable Laws, Landlord shall not permit any building, structure or obstruction (whether temporary or permanent) to be located within the portion of the Shopping Center identified as the "**No-Build Area**" on the Site Plan, other than lighting equipment, landscaping (not to exceed 5 feet in height at maturity), benches, trellises, or items which are existing as of the date hereof. To the extent any portion of the No-Build Areas is within a portion of the Shopping Center not owned or controlled by Landlord and Landlord has consent or approval rights over all or any portion of such area, such consent or approval shall not be granted if same would violate the restrictions set fort hereinabove. If Landlord does not have the right to withhold such consent or approval, then Landlord shall not be in violation to the extent such No-Build Areas are changed as described herein without Landlord's consent.*

In addition to protecting visibility corridors, many national and regional tenants will identify access points and driveways that must remain open for continuous customer access and may not be modified without tenant's consent. In addition to the customer access points and drives, many of those same tenants will identify access points and drives that are critical for service deliveries and also may not be changed without Tenant's consent. Similar to the No-Build Areas example set forth above, landlords will want to ensure an appropriate exception is made for changes required to comply with applicable laws. Furthermore, with respect to the service drives, landlords may want the ability to relocate those in connection with a future redevelopment, provided that continuous and equivalent access to accommodate tractor trailer deliveries is available to the tenant's loading dock. Here is an example of a negotiated provision regarding critical access points and drives with such exceptions:

> *Landlord covenants that the points of ingress and egress to and from the Shopping Center and the access drives identified on the Lease Plan as "**Critical Access Drives**" shall remain in an open and functioning manner, subject only to closures relating to a condemnation and temporary closures for maintenance or repairs or as required by Applicable Laws; provided, however, Landlord shall use commercially reasonable efforts to minimize any interference with the Critical Access Drives during such temporary closures, and provided further that Landlord shall commence and complete such repairs in a diligent and prudent manner.*

In addition to protecting view corridors and primary access drives, many retailers identify critical parking areas where landlords may not make any modifications (even the removal of a single parking space) or permit special events or other activities without first securing the tenant's consent. While landlords may seek to secure some form of limited flexibility, particularly during this day in age where events and promotional activities in the parking field have become increasingly common, these parking areas are a critical component for most major retailers, ensuring the customer's ability to park in a convenient location. In addition to these protected parking

fields, tenants will also require minimum parking ratios that ensure the landlord will continue to provide adequate parking within the entire development. At a time when developers are implementing Uber/Lyft pick-up and drop-off zones and seeking to convert excess parking areas into alternative uses, the parking requirements imposed upon developers imposes a potentially significant hurdle and one that requires careful consideration in connection with any potential redevelopment plans.

5. Remedies for Failure To Obtain Consent

a. Declaratory Relief

Tenants have a variety of remedies for a landlord's violation of site plan controls or landlord's obligation to obtain a required tenant consent. For example, a tenant may seek declaratory relief that a landlord has no right under the lease to modify the site plan or controls without tenant's consent.

b. Injunctive Relief

Courts have not been predictable on granting injunctions when a tenant brings suit to stop a landlord's construction. A Florida court granted a tenant an injunction to halt a landlord's construction of a new building in the parking lot without the tenant's consent as required by the lease, but the landlord was not required to convert the construction area back to usable parking spaces, its original state. (*Sacred Family Investments, Inc. v. Doral Supermarket, Inc.*, 20 So.3d 412 (Fl.App. 3 Dist. 2009)) But a Pennsylvania court denied a tenant's preliminary injunction to halt the construction of a new structure and ruled the tenant was not entitled to an injunction to demolish the structure mid-construction, because money damages were calculable and adequate. (*PSC Associates, LLC v. Simon Property Group, Inc.*, 2014 WL 10575443 (Sup.Ct. PA 2014).) These cases again show the importance of liquidated damage provisions which may reduce potential litigation costs and efforts.

c. Liquidated Damages

While landlords may initially want to reject any concept of liquidated damages, having a mutually acceptable liquidated damages provision is important for both tenants and landlords. Damages handed down by a judge may be unpredictable and liquidated damages provisions ensure a wronged party will receive fair compensation after a breach. Several years ago, Lord & Taylor ("LT") was unhappy when the owner of White Flint Mall in Kensington, Maryland decided to proceed with the demolition of a shopping center of which LT was a part. LT sued for injunctive relief, and the court in *Lord & Taylor, LLC v. White Flint, L.P.*, 780 F.3d 211 (4th Cir. 2015), focused on the reality of the situation, noting that because the shopping center was already partially demolished and much of the mall was already vacant, injunctive relief was not a reasonable remedy. 780 F.3d at 217. Fatal to LT's request for injunctive relief was the fact that:

> *"[r]estoring the mall to its former glory…would have required more than a negative prohibition on the site's redevelopment. It would have necessitated an affirmative injunction ordering White Flint to transform the now-fading Mall back into a 'first class high fashion regional retail shopping center' – the kind of order that is so hard to draft with specificity and then to enforce that Maryland courts generally will grant it only as a last resort."*

Id.

After losing its request for injunctive relief, LT amended its complaint to sue for damages resulting from White Flint's breach of contract. *Lord & Taylor, LLC v. White Flint, L.P.*, 849 F. 3d 567 (4th Cir. 2017). At trial, LT argued that the proposed redevelopment was a violation of the contract and that White Flint has hastened the shopping mall's decline in order to reap the rewards of redevelopment. LT sought damages for: (1) lost profits during construction; (2) its costs to redesign and reconstruct the store; (3) loss of bargained-for property rights, in the form of use restrictions and easements violated by the planned redevelopment. *Id.* The jury awarded LT $31 million in damages, and the circuit court affirmed. Presumably, the owner of the property would have preferred if the document had included a liquidated damages provision; it surely would have been less than $31M.

d. Waiver of Remedies

These potential remedies for violations also underscore the importance of waiver provisions in leases. These provisions ensure no claim is waived because time has passed or because other violations had proceeded

without complaints. The failure to complain of an act or omission by a landlord, no matter how long it continues, does not waive that parties' rights. In the Florida case mentioned above, the court rejected the landlord's waiver argument that the tenant had waived the right to their claim because they waited one month after cordoning off the premises to be used for the new build site to file for an injunction. The court was not convinced, and ruled the tenant had not waived their claim. (*Sacred Family Investments, Inc.*, 20 So.3d 412.) Another Florida court rejected a landlord's waiver argument that prior construction on a jointly-used parking area on the no-build zone had waived the restriction requiring joint consent for a new construction project. The waiver provision in the lease ensured the validity of the tenant's claim valid despite a previous violation that went unchallenged. (*Clear Channel Metroplex, Inc., v. Sunbeam Television Corp.*, 922 So.2d 229 (Fl.App. 3 Dist. 2005).) Having a waiver provision simplifies potential claims even further and shows the importance of these clauses to tenants.

6. Consents & COVID-19 Changes

As the onset of the COVID-19 pandemic changed restaurant dining as we knew it by moving operations outdoors, often into communal parking areas and sidewalks, one has to wonder if those changes will be permanent even if they violate existing site plan controls. Although the outdoor-dining revolution was a safer alternative to get Americans back to restaurants, this could be a potential area of dispute between neighboring tenants and landlords. If restaurants continue to occupy parking spaces at the front of or alongside their premises, they might be seen as commandeering a non-exclusive parking area to their own use, in violation of an existing restriction that requires the parking areas to remain non-exclusive.

Pre-pandemic, a court in California addressed this issue under different circumstances, but with results that could be similar under COVID outdoor dining changes. A California judge ruled that a grocery store using rear parking spaces as short-term storage space for transporting fresh items on site and long-term storage for holiday merchandise had misused the communal areas meant for all tenants. (*Muzzi v. Bel Air Mart*, 171 Cal.App.4th 456 (Cal.App 3 Dist. 2009).) The provision in the tenant's lease requiring all parking spaces be used non-exclusively was clear evidence for a judge to hand down declaratory relief that the grocery market had no authority to commandeer the spaces to the exclusion of other tenants and return them back to their intended state. (Id. at 634) One could imagine a similar scenario in which a restaurant creates an outdoor seating area within a small portion of the adjacent parking areas, but retail or other non-restaurant tenants do not have a need for such use and are excluded from using parking or communal areas. Landlords may be more lenient on a tenant's misappropriation of communal or parking areas because outdoor dining means business for the struggling restaurant sector and revenue means on-time rent payments. Whether tenants will come down hard on their co-tenants to enjoin exclusive use of parking or communal areas could be an area of increased litigation as the pandemic comes to an end. In the meantime, when drafting new REAs, it might make sense to give landlords wide latitude to convert specified portions of a development to other uses (e.g., testing facilities, outdoor dining areas, merchandise pickup areas) in the event of force majeure, especially a health emergency.

Co-Tenancy

While painfully obvious today, not that long ago (in relative terms) it would have been inconceivable that such long-standing name-brand retailers as Sears, Lord & Taylor, Toys "R" Us, and J.C. Penney, to name a handful, would either liquidate or shutter large portions of their retail portfolio through bankruptcy. So unfathomable, in fact, that the retail leasing industry was largely built on a promise from landlords that large anchor stores would always remain operating at the property, pursuant to a clause known well in the retail industry as "co-tenancy". For landlords, co-tenancy clauses are a dangerous business because a single event or a series of finite events can lead to the loss of enormous portions of a shopping center's rent. Take for example, a mall anchored by Sears, J.C. Penney, Dillard's and Nordstrom (the "Anchors"), with a large number of small shop tenants occupying the remainder of the mall. For most of the past several decades, the mall owner would have been so confident that those Anchors were going to continue to be part of the mall that they often granted the right to the small shop retailers to pay significantly reduced rent if, say, two of those four Anchors closed and were not replaced by a suitable replacement tenant (a "Co-Tenancy Failure"). Further, it is common that if a Co-Tenancy Failure continues for some period, the small shop tenant would be granted a termination right (this termination right may be ongoing or it might be a one-time right at a specified point in time). Accordingly, if the unthinkable happens and both Sears and J.C. Penney close at this mall, not only will the mall lose the vibrancy and foot traffic due to two of the largest occupants closing, it may also lose a very large percentage of the rent other tenants are obligated to pay. This can cause a marginally valuable asset to lose most of its value due to a single event.

The risks of co-tenancy clause in leases is not breaking news in the retail real estate industry. At least since the Great Recession, landlords have been facing the issue head-on. In fact, until recently, the tide seemed to shift where landlords welcomed the opportunity to get back (whether through re-purchase or termination of the lease, as applicable) anchor store space because it would potentially allow for the creation of significant value through redevelopment, ranging from simply re-tenanting the existing space with better performing tenants to complete redevelopment of a large portion of the property into experiential retail, or even other non-retail uses (such as multifamily, hotel, and office uses) that would complement the overall project and create value. Co-tenancy is so newsworthy now because COVID-19 has accelerated the rate of retail distress and bankruptcies, and fashion department stores (other than those with very strong omnichannel sales platforms) have been among the hardest hit retailers. The compounding effect of losing multiple anchors at a shopping center changes the entire dynamic. If a landlord loses one anchor tenant, but has the ability to get the space back and re-purpose it, it may be expensive and time consuming to do so, but ultimately it can be significantly accretive to the value of the asset. On the other hand, in situations where the landlord loses multiple anchors at a property, or an anchor and too large of a percentage of other occupancy, it becomes too much to overcome and the asset's value plummets to the point of no return, at least for the current owner and likely the current lender.

From a tenant's perspective, co-tenancy provisions have become more important than ever precisely because of the sea change in shopping center developments. Non-anchor tenants typically select developments (and the location of the premises they want to occupy within those developments) precisely because of the synergies that they expect co-tenants at the development to provide. If certain co-tenants abandon the shopping center, non-anchor tenants do not want to be the last tenant standing. This is especially true when they occupy an inline space in an enclosed mall, and the nearest anchor tenants have abandoned their stores.

While a tenant's desire to include a co-tenancy provision in a lease may be understandable, the case law with respect to co-tenancy provisions certainly suggests that co-tenancy provisions should be drafted with care.

1. <u>Pro Tip #1: Include Right to Substitute Co-Tenants</u>

Kleban Holding Co., LLC v. Ann Taylor Retail, Inc., 2013 United States Dist. LEXIS 168231 (D. Conn. Nov. 26, 2013): Landlord sued Ann Taylor, attempting to recoup unpaid rent based on Ann Taylor's invocation of the co-tenancy requirements. The relevant lease provision read:

> *(b) Operating: In the event Borders, Inc. or fifty percent (50%) of the other retail space in the Center, excluding Tenant, are not open and operating, Tenant shall be entitled to abate Minimum Annual Rent and in lieu thereof pay five percent (5%) of Gross Sales, not to exceed the Minimum Annual Rent otherwise payable in the absence of this paragraph, until the tenants meeting the foregoing requirements are again open and operating. Within thirty (30) days after the end of each calendar month that this Paragraph 61(b) shall be applicable, Tenant shall provide Landlord a statement showing the Gross Sales for such month and shall pay the amount due as percentage rent for such month. . .* *3-4.

Borders closed in May 2011 in connection with its bankruptcy. That same month, landlord replaced it with another bookstore, which remained open until September 2011. In November 2011, another bookstore open in the Borders space. Ann Taylor began paying the abated rent amount in July 2011.

Ann Taylor argued that the language of the lease unambiguously entitled it to pay abated rent if Borders was not occupying that space, while the landlord argued that it shouldn't apply if Borders was replaced with another retailer. *8. The court agreed with Ann Taylor, noting that when contract language "*is unambiguous, a court must give the contract effect according to its terms*." *9-10 (internal citations omitted).

20/20 Hindsight: With the benefit of hindsight, the landlord probably should have allowed itself to substitute Borders with other tenants. Ann Taylor might have required any substitute tenant to occupy a particular portion of the Borders space, e.g., not less than 80% of the gross leasable area.

2. <u>Pro Tip #2: Be Clear about Retroactivity of Reduced Rent</u>

Michaels Stores Inc. v. Sun Life Assur. Co. of Canada, 413 F. Supp. 3d 854 (D. Minn. 2019): Michaels sought a declaration of its rights under a lease to pay abated rent, as permitted by a co-tenancy provision. The primary issue before the court was whether Michaels could be permitted to exercise this right retroactively – more than two years after the option was triggered and after Michaels had continued to pay full rent, permitting Michaels to recoup over $250K in rent already paid. 413 F. Supp. 3d at 855.

Michaels entered its lease in 2004, which had a provision that required certain premises within the shopping center "*be open and continuously operated by an Anchor Tenant*." If an Anchor Tenant was closed for 120 days

and various other conditions satisfied, Michaels had the option to pay abated rent. *Id.* Sports Authority, an Anchor Tenant, closed in July 2016. Michaels asserted that it became aware for the first time that the co-tenancy requirement was not satisfied in January 2019, at which point it gave notice to landlord that it intended to invoke its option to pay abated rent effective July 28, 2016. *Id.*

The co-tenancy provision also gave Michaels the right to terminate its lease after 12 months of paying the abated rent if the co-tenancy requirement still wasn't satisfied. However, the provision went on to state that:

> *"[i]n the event Tenant continues to pay Alternative Rent and has not elected to terminate this Lease at such time due to the non-satisfaction of the On-Going Co-Tenancy Requirement, Landlord will have the right to demand by written notice delivered to Tenant on or before the last day of the fourteenth (14th) full calendar month following the initial non-satisfaction of the On-Going Co-Tenancy Requirement (the "Demand Notice") that Tenant do the following: either (i) terminate this Lease by thirty (30) day written notice delivered to Landlord within sixty (60) days after Tenant's receipt of Demand Notice or [**11] (ii) discontinue Alternative Rent and recommence the payment of Minimum Rent per Paragraph 6 of Basic Lease Provisions on the sixtieth (60th) day after Tenant's receipt of the Demand Notice.*

Id. at 858. The court ruled in landlord's favor, noting that the provision could not be understood to give Michaels the right to retroactively invoke abated rent, because it would render useless the demand rights given to the landlord. *Id.* The court ultimately dismissed with prejudice Michaels' complaint against the landlord. *Id.* at 860.

20/20 Hindsight: In hindsight, Michaels might have required landlord to notify it if the co-tenancy provision is not satisfied (the landlord would be unlikely to agree to that). Alternatively, Michaels could have established a lease administration process whereby Michaels monitored the locations where it has the benefit of co-tenancy provisions on a fixed schedule, e.g., once every 6 or 12 months, in order to confirm that a co-tenancy violation does not exist.

3. Pro Tip #3: Be Careful About Conditions

DN Reynoldsburg v. Shoe Show, Inc., 2020 United States Dist. LEXIS 179631 (S.D. Ohio Sept. 29, 2020): Shoe Show rented space at landlord's shopping center in 2015. Shoe Show argued that its co-tenancy provision permitted it to pay 5% of gross sales until/unless an opening condition was satisfied, namely the opening of three retailers: Sports Authority, TJ Maxx, and Maurices. Sports Authority, however, never opened – it filed for bankruptcy in March 2016 and rejected the lease. Shoe Show opened in August 2016, after learning that Sports Authority filed for bankruptcy. Landlord leased the Sports Authority space to a furniture store in November 2017. *2.

The issue before the court was whether the lease required Shoe Show to pay full rent after the furniture store opened. *5. Shoe Show argued that it specifically argued for the particular co-tenants listed in the Opening Co-tenancy provision and therefore could not be required to pay the full rental amount – ever, since Sports Authority would never be opening. Landlord argued that the subsequent (ongoing) co-tenancy provision in the lease, which provided procedures for replacing co-tenants not open for business, meant full rent could be charged after November 2017. *8, *10.

Noting that "*the contract is silent on an issue that is central to the contract: the rental obligation due when an original co-tenant failed to open and never will open*," the court denied both parties' motions for summary judgment, allowing the case to proceed to a trial on the merits. *18.

20/20 Hindsight: Be careful about differences between your opening and operating co-tenancy provisions. Was it truly the parties' intention that the co-tenants could be substituted only after tenant initially opened? We may never know.

Other Hurdles to Redevelopment

In addition to consent rights, REAs and leases sometimes include other provisions that may (arguably) limit a developer's right to redevelop a shopping center.

1. "First Class" or "Luxury" Requirements

Some leases or REAs include language that either require a development to be a "first class" shopping center or otherwise suggest that a shopping center will be "first class" or will be occupied by "luxury" tenants throughout the relevant term. Can tenants of the shopping center rely on this language to attempt to block redevelopment? There does not appear to be a commonly used definition for "first class" or "luxury" and accordingly, courts are likely to deem such a term ambiguous. This allows the court to consider parol evidence and look to the intent of the parties when considering an alleged breach of a lease or an REA incorporating requirements with respect to a "first class" or "luxury" shopping center.

a. Definition of “First Class”

Jo-Ann Stores, Inc. v. Property Operating Co., LLC, 91 Conn. App. 179 (2005): The Appellate Court of Connecticut considered whether a replacement for an anchor tenant was a “first class retail establishment”. In this case, the anchor tenant was a Clothing Super Store. The lease included a co-tenancy provision allowing Jo-Ann to pay abated rent in the event that Clothing Super Store vacated the space. If the owner did not fill the vacated space with “*a comparable substitute tenant which uses and occupies said Anchor Tenant’s space for a first class retail purpose (e.g. not a flea market, night club, second hand store, or a furniture store)…,*” Jo-Ann could either continue paying the abated rent amount or terminate its lease. 91 Conn. App. at 183 (quoting lease). The anchor tenant initially assigned its lease to a children’s outlet clothing store, who then sublet a large portion of the space to Curley’s Children’s World, which included a recreation center, a day care center, and a small children’s retail section. *Id.* at 184. The appellate court agreed that the term “first class retail purpose” within the lease was ambiguous, noting that the lease defined the term solely in the negative. *Id.* at 191. The trial court had considered conflicting evidence regarding whether Curley’s was a first class retail establishment, and had concluded, without defining the term, that it was not. The appellate court upheld this ruling.

b. Definition of “Luxury”

Fairfax Square LLC v. Hermes of Paris, Inc., 89 Va. Cir. 406 (2015): Hermes was one of the original Fairfax Square tenants in 1990. In 2014, Hermes sent a notice to the landlord that it had been in default of a material covenant since 2011. That provision stated that:

> *Landlord covenants to Tenant that it will operate the retail and office portion of the Property as a premium office and retail center. It is a material covenant on the part of the Landlord that the mix of tenants in the retail section of the Property shall be composed of quality retail establishments which sell the highest quality good and which are "luxury" tenants selling premium brands, such as by way of example, Tiffany's (sic), Fendi and Gucci, and shall operate their establishments in a manner in which suggests the highest quality for their type of operation. High quality service businesses such as banks are also permitted.*

89 Va. Cir. at 407 (quoting lease). At trial, one of the issues considered was whether the tenants in place met the requirement regarding luxury tenants. The court found the provision ambiguous, and focused on the shared characteristics of each of the three luxury tenants identified as examples in the lease: they are iconic and easily recognized global brands that design and sell a mix of luxury goods, they sell their own brands, and they are not appliance companies. *Id.* at 417. Ultimately, the court concluded that the landlord had breached this provision on the lease, reasoning that in the context of this lease provision “luxury” meant iconic international designers of luxury goods associated with the fashion world. *Id.* at 415.

2. Definition of Retail

What about a reference to “retail”, whether in a co-tenancy provision or an REA generally, e.g., 85% of the gross leasable area of the development must be occupied by “retail” tenants. The answer to this question is more straightforward – you can assume that “retail” refers to stores, not restaurants, movie theaters, banks, etc.

a. Day care center is not retail. *Jo-Ann Stores, Inc. v. Property Operating Co., LLC*, 91 Conn. App. 179, 189 (2005) (“*In ordinary usage, ‘retail’ is defined as ‘the sale of commodities or goods in small quantities to ultimate consumers’ and ‘engaged in the sale of commodities at retail.*’”)

b. Movie theaters, restaurants, banks, and medical centers are not retail establishments. *In re Sun TV & Appliances, Inc.*, 234 B.R. 356, 361 (Bankr. D. Del. 1999).

3. Definition of Shopping Center

What if the REA or lease refers to a “shopping center”? Does that impact a developer’s ability to repurpose a shopping center for other uses? According to the case law, a list of factors are considered when determining whether an area of retail establishments constitutes a shopping center. This list includes:

a. a combination of leases;
b. all leases held by a single landlord;
c. all tenants engaged in the commercial retail distribution of goods;
d. the presence of a common parking area;
e. the purposeful development of the premises as a shopping center;
f. the existence of a master lease;

g. the existence of fixed hours during which all stores are open;
h. the existence of joint advertising;
i. contractual interdependence of the tenants as evidenced by restrictive use provisions in their leases;
j. the existence of percentage rent provisions in the leases;
k. the right of the tenants to terminate their leases if the anchor tenant terminates its lease;
l. joint participation by tenants in trash removal and other maintenance;
m. the existence of a tenant mix; and
n. the contiguity of the stores.

In re Joshua Slocum, Ltd., 922 F.2d 1081, 1087-88 (3d Cir. 1990). The presence of non-retail establishments, including restaurants, banks/ATMs, movie theaters, travel agents, etc., does not take away the "shopping center" identity of an area. As the court in *In re Sun TV & Appliances, Inc.* noted, these types of non-retail establishments are typically found in malls as a convenience and attraction for shoppers, and have the "symbiotic relationship with the retail tenants and each other that the Third Circuit [in *Joshua Slocum*] found necessary to create a shopping center." 234 B.R. at 361.

<u>Parting Thoughts and a Call for Collaboration</u>

In conclusion, there have been headwinds facing the retail real estate industry for several years now. That pain has been dramatically accelerated due to COVID-19 and generally by a rise in retailer bankruptcies. Things will likely get worse before they get better. One of the most important things that can happen for the sake of the retail real estate industry's survival over the next 5-10 years is greater collaboration among shopping center stakeholders when it comes to potential redevelopment. Rather than thinking of the short-term gain of exacting consideration for a consent, tenants and REA parties would be well served to consider how much better their sales and business results may be at a property that has undergone a redevelopment. On the flip side, tenants hope that developers will be sympathetic to their concerns about how redevelopment may impact their business on a short-term (e.g., construction noise, dust, interruption of utilities, difficulty accessing the loading dock or the front entrance from the parking lot) and long-term basis (when tenants select sites, they carefully consider who their co-tenants will be, and their analysis may change if a co-tenant is a hotel rather than another retailer). The opportunity for collaboration seems timely, given that many (not all) landlords and tenants worked together more closely in 2020 than possibly ever before to address the financial impact of COVID-19, with rent deferrals and abatements (in some instances in return for longer lease terms, relaxation of co-tenancy requirements or other concessions). The entire industry should hope that the goodwill shown in 2020 will spur greater collaboration going forward.