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Peer to Peer 4

Co-tenancy in a post-COVID world - has/should anything change?

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by:

Gary Glick, Esq.
Cox Castle & Nicholson LLP
2029 Century Park East, Suite 2100
Los Angeles, CA 90067
gglick@coxcastle.com

Robert Ondak, Esq.
Benesch, Friedlander, Coplan & Aronoff LLP
200 Public Square, Suite 2300
Cleveland, OH 44114
rondak@beneschlaw.com

COURSE SUMMARY

The COVID-19 pandemic has changed the way we work, socialize and complete our day-to-day tasks, including how we shop for goods and services. As we transition into a post-COVID world there are different schools of thought as to how these changes will impact our society moving-forward. Are we forever changed or will it be back to business as usual? In this advanced peer-to-peer session we will explore 2 fact patterns identifying how COVID-19 has impacted co-tenancy provisions in retail leases and also address if it has, or should, change how we negotiate this critically important provision that is included in most sophisticated retail leases.

COURSE HYPOTHETICALS

HYPOTHETICAL NO. 1

For purposes of this first hypothetical, let's presume it is now January 15, 2022. While we were able to avoid a massive coronavirus outbreak in the Fall of 2021 (so that the ICSC law conference could be attended in-person), a combination of year-end holiday parties, the easing of travel restrictions and a new coronavirus variant in the U.S. results in a rapid up-tick in coronavirus cases causing the CDC to again recommend the shut-down of non-essential businesses, including the majority of tenants operating in retail shopping centers nationwide. However, not all government officials concur with the CDC's recommendation. Some states follow the CDC's recommendation and mandate the closure of non-essential businesses. Other states recommend, but do not mandate, the closure of restaurants and other businesses where people congregate, and a handful of states openly reject the CDC's recommendation with support from state health officials that contradicts the CDC's findings and issue their own health advisory indicating that there is no reasonable justification for mandating the closure of non-essential businesses.

Similar to late March and early April of 2020, landlords and tenants throughout the nation quickly assemble their leases to determine their respective rights and obligations as a result of this most recent coronavirus outbreak and they call you for your expert analysis and opinion. Your client delivers you the following excerpts from leases in its portfolio. As you receive the leases referenced below, you are also informed of the following:

- Bullseye, a large, national tenant (occupying 100,000 sf) elects to follow the CDC's recommendation and closes business operations at all of its stores nationwide.
- As a result of the conflicting direction from government officials where Old Army, a mid-box national tenant (occupying 10,000 sf) has stores, Old Army elects to allow each store manager to decide if a store will remain open or close.
- Kyle's (occupying 50,000 sf) and JB's Club (occupying 100,000) elect to remain open; however, they significantly reduce their operating hours, going from 24/7/365 to 6 hours a day Monday through Friday, 4 hours on Saturday and closing on Sunday.
- OK Buy (occupying 40,000 sf) also elects to remain open and extends its hours, but only permits BOPIS (buy online, pickup in-store).
- WSD (occupying 20,000 sf) closed business operations on January 5, 2022 for remodeling purposes.
- The shopping center consists of approximately 450,000 square feet.

Lease 1 - co-tenancy and force majeure provisions

CO-TENANTS : the following five (5) tenants: (i) Old Army ; (ii) Kyle's ; (iii) Bullseye; (iv) JB's Club ; and (vi) OK Buy. CO-TENANCY: In the event less than three (3) of the Co-Tenants or less than sixty-five percent (65%) of the remaining gross leasable area of the Shopping Center, exclusive of the Co-tenants and the Demised Premises, are open and operating for a period of thirty (30) consecutive days (other than temporary closures due to remodeling, fire or casualty and events of force majeure which shall not exceed one hundred fifty (150) days).

If Lessor or Lessee shall be delayed or hindered in or prevented from the performance of any act required hereunder, other than the payment of rent, by reason of strikes, lockouts, labor troubles, inability to procure labor or materials, failure of power, fire or casualty, acts of God, riots, insurrection, war or other reason of like nature, then performance of such acts shall be excused for the period of the delay and the period for the performance of any such act shall be extended for a period equivalent to the period of such delay.

Lease 2 - co-tenancy and force majeure provisions

Co-Tenancy. If at any time during the Term of this Lease two (2) or more of the following tenants/occupants: (i) OK Buy, (ii) Kyle's, (iii) JB's Wholesale, (iv) WSD, (v) Michelle's, or (vi) Bullseye or their successors, assigns or Replacement Tenant(s) (as hereinafter defined) (individually an "Anchor Tenant" and collectively the "Anchor Tenants") cease to operate within ninety (90) days after the date two (2) or more of the Anchor Tenants cease operation in the Shopping Center (the "Vacation Period"). Notwithstanding the foregoing, if the Co-Tenancy Requirement is not satisfied as a result of Force Majeure, casualty, condemnation or the making of repairs or restorations following any casualty or condemnation event, then Tenant shall not be entitled to exercise any of the remedies set forth in this Section with respect to the specific failure of the Co-Tenancy Requirement but not with respect to any future failure of the Co- Tenancy Requirement.

If Landlord or Tenant is prevented or delayed in the performance of any improvement or repair or fulfilling any other obligation required under this Lease due to delays caused by fire, catastrophe, strikes or labor trouble, civil commotion, acts of God, governmental prohibitions or regulation, inability or difficulty to obtain materials or other causes beyond the performing party's reasonable control, the performing party shall, within ten (10) days of the event causing such delay, provide written notice to the other party of the event causing the delay and the anticipated period of delay, and the period of such delay shall be added to the time for performance thereof. If the performing party fails to provide notice to the other party of the force majeure delay within such ten (10) day period, then the performing party shall not be excused from the timely performance of such obligation regardless of the cause. This provision shall not excuse Tenant from its obligation to pay Minimum Rent and Additional Rent, except when such payment is excused pursuant to other provisions of this Lease.

Lease 3 - co-tenancy and force majeure provisions

Co-Tenancy. If at any time during the term of this Lease Bullseye, or its successors, assigns or replacements, ceases to operate and vacates the premises. In the event Landlord has not satisfied the Co-Tenancy Requirement within twelve (12) consecutive months following the failure of the Co-Tenancy Requirement (the "Vacation Period"). Notwithstanding the foregoing, if the Co-Tenancy Requirement is not satisfied as a result of force majeure, casualty, condemnation or the making of repairs or restorations following any casualty or condemnation event, then Tenant shall not be entitled to exercise any of the remedies set forth in this Section.

No definition for force majeure; however, force majeure is referenced in the operating and co-tenancy sections of the Lease.

Lease 4 - co-tenancy and force majeure provisions

CO-TENANCY: If there are not at least three (3) of the following named merchants or their replacements: Bullseye, JB's Club, OK Buy and Kyle's that are open and operating retail business in the Shopping Center.

Except as otherwise expressly provided in this Lease, Landlord and Tenant shall be excused for the period of any delay in the performance of any obligations hereunder when prevented from doing so by a cause or causes beyond Landlord's or Tenant's control, as applicable, which shall include, without limitation, all labor disputes, riots, civil commotion, war, war-like operations, invasion, rebellion, hostilities, military or usurped power, sabotage, governmental regulations or controls, inability to obtain permits or approvals from governmental authorities, fire or other casualty, acts of God or any delay experienced by either party resulting from the COVID-19 pandemic and/or a subsequent virus or bacteria pandemic ("Force Majeure"); provided, however, Force Majeure shall not excuse prompt and timely payments when due under this Lease, except when such payment is excused pursuant to other provisions of this Lease.

Lease 5 - co-tenancy and force majeure provisions

CO-TENANCY: Provided Tenant shall not be in default of any term or condition of this Lease, beyond all applicable notice and cure periods, and Tenant is open and operating its business in the Premises, excluding closures due to force majeure, eminent domain, casualty and/or remodeling, if at any time tenants of the Shopping Center (excluding Tenant's premises (5,000 sf), Bullseye and JB's Club) are not open in at least sixty percent (60%) of the gross leasable area of the Shopping Center, then Tenant shall continue to occupy the Premises and operate its business therein subject to an adjustment in the computation of rent as hereinafter provided.

If Landlord or Tenant is delayed or prevented from the performance of any work or other requirement under this Lease for which it is obligated to perform, and such delay or hindrance is due to causes beyond its reasonable control, then such performance shall be excused for the period of delay, and the time period for performance shall be extended by the same number of days in the period of delay.

Questions for each group to consider:

1. If you represent the tenants for each of Leases 1-5 identified above, based on the foregoing lease terms and facts, which lease is most tenant friendly and why?
2. If you represent the landlords for each of Leases 1-5, based on the foregoing lease terms and facts set forth above, which lease is most landlord friendly and why?
3. Which lease most equitably balances the interests of the landlord and the tenant and why?
4. Based on your experience and having navigated the prior COVID-19 pandemic, identify deal terms that you believe may be advantageous to the landlord and/or tenant if they were included in the co-tenancy requirements set forth above.

HYPOTHETICAL NO. 2

For purposes of this second hypothetical, let's presume that we are looking at a lease that was negotiated prior to COVID-19. The lease is with a national beauty supply store named Maya's Beauty. Maya's Beauty will occupy approximately 15,000 square feet in a mixed-used project that is being renovated in Pandemic, California, and will contain office, retail and multi-family uses.

The opening co-tenancy clause for Maya's Beauty reads as follows:

"Tenant shall not be required to open for business in the Premises nor shall Tenant be obligated to commence payment of Rent unless and until all of the following conditions have been satisfied (collectively, "Opening Co-Tenancy Requirements"): each Named Co-Tenant shall be open to the public at the Project fully stocked and staffed for the conduct of their respective primary businesses in the locations shown on the Site Plan. In the event Tenant elects to open for business in the Premises prior to the satisfaction of the Opening Co-Tenancy Requirements, then, notwithstanding the foregoing, beginning as of the Rent Commencement Date and continuing until the Opening Co-Tenancy Requirements are satisfied and Landlord has provided Tenant written notice thereof, Tenant shall pay to Landlord (in lieu of Rent) Alternate Rent. If Tenant does not elect to open for business until the Opening Co-Tenancy Requirements have been satisfied, Tenant's obligation to pay Rent hereunder shall not commence until the later of either: (A) the earlier of either (1) one hundred twenty (120) days after satisfaction of the Opening Co-Tenancy Requirements (and receipt of written notice thereof from Landlord), or (2) Tenant's opening for business in the Premises; or (B) the Rent Commencement Date. If Landlord does not provide Tenant with written notice of the satisfaction of the Opening Co-Tenancy Requirements (the "Compliance Notice") on the date of the satisfaction of the Opening Co-Tenancy Requirements, the payment of Rent shall be retroactive to the date of the satisfaction of the Opening Co-Tenancy Requirements but in no event no earlier than sixty (60) days prior to the date of receipt of Landlord's Compliance Notice. In addition, in the event that the Opening Co-Tenancy Requirements have not been satisfied within one (1) year from and after the expiration of the Construction Period (which 1-year period is referred to herein as the "Waiting Period"), Tenant may elect to (i) terminate this Lease by giving written notice to Landlord, or (ii) commence paying full Rent (and open for business from the Premises pursuant to the terms of this Lease) subject to any other reductions or abatements in Rent as provided in this Lease. In the event that Tenant does not terminate this Lease within ninety (90) days following the expiration of the Waiting Period, Tenant shall be deemed to have elected to commence paying full Rent to Landlord (subject to any other reductions or abatements in Rent as provided in this Lease) effective upon the expiration of the Waiting Period. In the event Tenant terminates this Lease as provided herein, this Lease shall terminate ninety (90) days after the date of such termination notice unless the Opening Co-Tenancy Requirements are satisfied within thirty (30) days after Tenant's termination notice and Landlord provides evidence reasonably satisfactory to Tenant thereof within such thirty (30) day period. If this Lease is terminated in accordance with the foregoing, both parties shall be released from any and all obligations and liabilities hereunder, except (i) for such obligations and liabilities that expressly survive the termination hereof and (ii) Tenant may pay Alternate Rent through the termination date. In the event this Lease is terminated pursuant to this Section, Landlord shall pay to Tenant the Termination Payment on or before the termination date set forth in the termination notice."

The Name Co-Tenants are: Bullseye, Whole Planet Foods and CMA Theatres.

"Comparable Replacement Tenant" is defined to mean a national or regional retail chain that (i) has been operating for at least five (5) years, (ii) has at least twenty-five (25) stores, (iii) is a retailer of substantially the same quality as is typically found in projects similar to the Project in the Pandemic Bay Area, and (iv) occupies at least eighty percent (80%) of the Gross Floor Area occupied by the applicable Named Co-Tenant and has no more than two (2) users if the space is demised, and (v) has an initial lease term for its premises at the Project of at least five (5) years.

The force majeure provision in the Lease read as follows:

"If either party shall be prevented or delayed from punctually performing any obligations or satisfying any condition under this Lease by any strike, lockout, labor dispute, unavailability of labor or materials, act of God such as earthquake, hurricane, tornado, fire or flood, unusual governmental or quasi-governmental restriction, regulation, control or delay, enemy or hostile governmental action, civil commotion, insurrection, sabotage, fire or other casualty, or any condition caused by the other party ("Force Majeure"), then the time to perform such obligation to satisfy such condition shall be extended on a day-for-day basis for the period of the delay caused by such event; provided, however, that the party claiming the benefit of this provision shall, as a condition thereto, give notice to the other party in writing within twenty (20) days of the incident specifying with particularity the nature thereof, the reason therefor, the date and time such incident occurred and a reasonable estimate of the period that such incident will delay the fulfillment of obligations contained herein. Failure to give such notice within the specified time shall render such delay invalid in extending the time for performing the obligations hereunder. This Section 25.2 shall not apply to the inability to pay any sum of money due hereunder or the failure to perform any other obligation due to the lack of money or inability to raise capital or borrow for any purpose. Notwithstanding the foregoing, this Section 25.2 shall not act to extend the Outside Delivery Date with respect to Tenant's termination right but shall act to extend the Anticipated Delivery Date with respect to Landlord's obligation to pay the Late Delivery Fees."

Tenant did not open for business on the Rent Commencement Date (which would have been June 1, 2020) because it claimed that the opening co-tenancy provision was not satisfied. Landlord had entered into leases with the required co-tenants, which leases required such tenants to open by dates that would have satisfied the requirements of Maya's Beauty's opening co-tenancy clause. However, most of such tenants did not open on time because of governmental restrictions on construction and operations due to COVID-19. Landlord has indicated to Tenant that it was required to begin the payment of rent and additional rent on June 1, 2020, because the opening co-tenancy would have been satisfied but for force majeure events (i.e., the restrictions due to COVID).

Questions:

1. Does Landlord have a legitimate argument that Tenant should commence the payment of base rent and additional rent on June 1, 2020? If not, why not?
2. If the opening co-tenancy clause were drafted post-COVID, how would it be different? What changes would Landlord request? What changes would Tenant request?
3. What changes would each of Landlord and Tenant make in the drafting of the force majeure provision clause post-COVID as it related to the co-tenancy clause?

COURSE MATERIALS

While governmental programs and tax policies, such as the paycheck protection program (“PPP”) loans, COVID-19 economic injury disaster (“EIDL”) loans, restaurant revitalization fund and employee retention tax credit (“ERC”), gave many businesses, including retail businesses, the economic assistance they needed to survive mandated closure of non-essential businesses and the reduction in consumer demand for goods and services caused by governmental restrictions imposed to control the spread of COVID-19, many retail tenants are still in the process of paying landlords for rent that was deferred and otherwise dealing with the downturn in consumer demand caused by the COVID-19 pandemic. As a result of the impact COVID-19 had on the retail industry, many landlords and tenants, are revisiting their leases to determine if additional protections should be included therein. As anyone who practices in the retail real estate industry can tell you, the co-tenancy provision is a critical deal term in many retail leases, and pre-COVID, was one of the most fiercely negotiated lease provisions. As we transition into a post-COVID world, it will be interesting to see the trends that emerge from our collective experience of dealing with the fallout from the COVID-19 pandemic.

As we evaluate how to respond, and possibly change our leases and co-tenancy requirements, as a result of situations landlords and tenants experiences from the COVID-19 pandemic, it is important to revisit the intended purpose of various lease provisions, including lease co-tenancy clauses, to better understand their nature and purpose.

A “co-tenancy clause” imposes a requirement on the landlord that certain leasing thresholds and/or critical tenants must exist at a shopping center as a condition for a tenant to pay the rent and/or additional rent obligations otherwise agreed to in the lease. The basic premise behind a co-tenancy clause is that the tenant is willing to pay the agreed upon economic terms included in a lease because of the vibrancy created by a well-occupied shopping center with a certain merchandise and tenant mix or as a result of a specifically named retailer or retailers, and if those conditions do not exist, then the benefit of the bargain the tenant thought it was getting when it signed its lease is not there, and as a result, a reduction of the economic terms of the lease, and maybe other remedies, are warranted.

While historically co-tenancy requirements were reserved for anchor tenants and major national retail tenants, this deal term has become more commonplace in all tenant categories. Landlords are often under pressure to lease vacant space as quickly as possible and granting what is viewed as a reasonable or relatively safe co-tenancy clause is a calculated risk that many landlords are willing to take in order to get deals completed. Coming-out of COVID, landlords may be re-evaluating their definition of what constitutes a safe co-tenancy, or alternatively they may be including some additional requirements to protect their interests.

The co-tenants are often the anchor tenants of shopping centers. Anchor tenants historically often do not have an obligation to operate their businesses, consequently, inherent in co-tenancy clauses is the concept that the landlord is taking the calculated business risk that a specific tenant or group of tenants will continue to operate. Co-tenants are often larger or popular stores that attract increased consumer traffic to a shopping center, which traffic benefits the other tenants of the shopping center. The fundamental question both landlords and tenants should be asking one another in a post-COVID world is which party should bear the burden for closures, such as governmentally mandated closures or other limitations imposed on businesses that reduce the assembly of large groups of people. An argument can be made that when a landlord agrees to a co-tenancy requirement in its lease that it inherently assumes a business risk that it does not directly control, and consequently, whether or not the landlord could do anything to prevent a co-tenancy failure from occurring is irrelevant. Conversely, a strong case can be made that landlords are not sureties, and while landlords can provide some protection in their leases to ensure the continued vibrancy of shopping centers, they cannot insure tenants against all risks. The real nature of a co-tenancy requirement is to protect ensure the intrinsic value of the shopping center remains in-place. If a co-tenant or co-tenancy requirement is violated as a result of a force majeure event, such as a virus that temporarily closes business operations, then the landlord should not be expected to protect against such a risk, and if tenants insist on the same, then maybe additional insurance will need to be obtained by landlords to address this additional exposure, the cost of which will need to be past-through to the tenants through additional insurance charges or rents will need to increase to address such exposure.

Whether or not a tenant obtains a co-tenancy clause in its lease, and the particulars of such co-tenancy clause, are predominately dependent upon the deal specific negotiating power of both the landlord and tenant. In a high-demand area, a landlord may be able to avoid including co-tenancy clauses in its leases or may be able to significantly reduce the risk imposed by co-tenancy clauses that it grants in its leases. However, more often, particularly with national tenants, a tenant will have specific leasing criteria that cannot be deviated from or the tenant will not be willing to enter into the deal, and those leasing criteria often include some form of a co-tenancy requirement.

The two (2) most common types of co-tenancy clauses are the “opening co-tenancy” and “ongoing/operating co-tenancy”.

Opening co-tenancy

An opening co-tenancy is intended to ensure that retailers are not required to open for business on the required rent commencement date, unless and provided that certain other tenants are open and operating their respective business at the shopping center. The co-tenant or co-tenants are often specifically identified by name or as a specific minimum percentage of the total gross leasable area of a shopping center. Often, the co-tenancy terms are negotiated before the attorneys are engaged, at the letter of intent stage of the leasing process. This reality can have far-reaching consequences as both landlords and tenants may not be fully focused on the consequences of terms included (or not included) in the letter of intent or term sheet. If possible, it is often better to negotiate the majority of the co-tenancy details during the lease negotiations when all participants are focused on the deal. Alternatively, the most significant aspects of the co-tenancy clause can be addressed in the letter of intent or terms sheet, such as the scope of the co-tenancy clause or whether or not the lease will contain a co-tenancy clause; however, it is often more efficient to reserve the right to address the other specifics of a co-tenancy clause during the lease negotiations when both the business and legal representatives for the landlord and tenant are more focused on the transaction and can think through all of the implications of the co-tenancy terms and whether the same are acceptable to the parties. There is nothing worse than having to re-negotiate co-tenancy terms included

in a letter of intent that were not fully considered by both the parties. When this happens, it strains the relationship between the tenant and landlord, a part to the lease may lose creditability and it can delay the completion and execution of the lease.

Ongoing/Operating co-tenancy

An ongoing or operating co-tenancy clause covers co-tenancy requirements after a tenant has opened for business in its premises and generally continues throughout the term of the lease. An ongoing/operating co-tenancy clause usually provides that if one or more specified co-tenant(s) is/are no longer open and operating for business, or in the event the shopping center drops below a certain occupancy threshold, then a co-tenancy failure occurs. In some instances the landlord will be granted a period of time to secure a replacement tenant or replacement tenants. This is generally referred to as a "vacation period". The theory behind granting a vacation period is that all of the co-tenancy risk should not be placed completely on the landlord. The reality may be that the shopping center is a vibrant center and that the particular named co-tenant, which historically operated a successful business, is no longer the same business. The shopping center still has the same intrinsic value to its tenants and the named co-tenant went out of business at the shopping center for a variety of factors, but the shopping center itself was not one of those factors. The "vacation period" affords the landlord a reasonable period of time to locate a replacement tenant, negotiate a lease with such replacement tenant, build-out its premises and have the replacement tenant open for business at the shopping center. If all of this is accomplished prior to the expiration of such "vacation period", then the tenant's remedies for an ongoing/operating co-tenancy failure will not apply and the replacement tenant will take the place of the original co-tenant under the lease moving forward throughout the remainder of the lease term. In practice, when a "vacation period" is included in an ongoing/operating co-tenancy clause, it often is not long enough in duration to allow for the time that is required to identify a replacement tenant, negotiate a lease with the replacement tenant, build-out the premises for such tenant and get it open for business, nonetheless, vacation periods offer some relief to landlords when ongoing/operating co-tenancy failures occur and more evenly allocate co-tenancy risk and exposure between the landlord and tenant.

Replacement Tenants

One of the most critical components of a co-tenancy clause is the definition of replacement tenant(s) for a named co-tenant that vacates the shopping center. In some instances the lease will not include any definition for a replacement tenant(s), which may give the landlord latitude to replace the named co-tenant with any tenant or a combination of tenants. Not including a definition for the replacement tenant(s) may be problematic for the tenant because the replacement tenant(s) may not be of the same caliber as the original co-tenant and/or the nature of the replacement tenant(s) business may not generate the same customer traffic as the original co-tenant. The landlord should also be concerned about not properly defining the permitted replacement tenant(s) for a named co-tenant as the landlord may not be able to lease the entire footprint of the original co-tenant's premises, and consequently, the tenant may challenge that the co-tenancy requirement has not been satisfied because the entire original co-tenant's premises is not occupied by the replacement tenant. Usually, the landlord and tenant will agree upon certain standards or criteria for permissible replacement tenant(s). If the original co-tenant occupies a large premises that is awkwardly shaped, the landlord will generally be given some latitude to lease less than the entire original co-tenant's premises to a replacement tenant or tenants (typically somewhere between 60% and 80% of the original co-tenant's premises). Additionally, if the space is larger (over 20K sf) then the landlord will usually be permitted to lease the original co-tenant's space to more than one replacement tenant.

Co-tenancy Remedies

It is important to understand that a co-tenancy failure is not directly the landlord's fault. While the parties may agree to specific remedies, a co-tenancy failure will not be treated in the same manner as a violation of an exclusive use or prohibited use or the landlord's failure to maintain the common areas of the shopping center, which obligations, for the most part, are directly within the landlord's control. Recognizing that a co-tenancy requirement, by its very nature, is a deal term that is outside the direct control of the landlord, the tenant's remedies are usually very specific and in most instances limited to a reduction in rent or alternative rent calculation and/or a right to terminate the lease under certain circumstances.

If the co-tenancy failure is an opening co-tenancy failure, then the tenant is often given the option to delay the opening date until after the co-tenancy requirement is satisfied or the tenant will be given the option of opening for business any paying reduced or alternative rent until the opening co-tenancy requirement is satisfied. The alternative rent most often is a percentage of monthly sales or a percentage of the minimum rent otherwise payable under the lease. If the alternative rent is calculated based on a percentage of sales, then an operating requirement will need to be included in the lease to keep the tenant honest. The worst situation for a landlord would be to have a tenant that elected, for unrelated business reasons, to go dark and cease business operations in its premises, then for a co-tenancy failure to trigger the payment of alternative rent based on a percentage of sales, which effectively would result in the unintended windfall of the dark tenant paying no rent merely because a co-tenancy right was triggered. The tenant may contend that the co-tenancy failure will make it more challenging for the tenant to negotiate a sublease of its premises or to assign the lease, which may or may not be a value claim under the circumstances. The middle-ground position when granting an alternative rent for a co-tenancy failure that is based on a percentage of sales is to also provide that if the tenant does not operate for any reason (or no reason), then the alternative rent will be based on a percentage of the minimum rent otherwise payable under the lease. With this middle-ground position, the tenant does not completely lose its remedy for the co-tenancy failure and the landlord does not lose all rent from the premises as a result of the co-tenancy violation.

If the co-tenancy failure continues for an extended period of time, typically a 6 month to 24 month period, based on deal specific factors, then the tenant will be granted a right to terminate the lease. Tenants invest in specific locations that same as landlords, and in the event of changed circumstances, the tenants may need to re-evaluate whether the shopping center is a viable location at which its business can effectively operate. Nonetheless, the co-tenants at a shopping center are just one factor, among many other factors, that determine whether a tenant will be successful at a location, so the alternative rent/reduced rent for a specified period of time and then a termination right gives the tenant some short-term economic relief and then an inflection point at which to determine if it wants to continue operating at the location or cut its losses and look for other opportunities.

Additional Co-Tenancy Considerations

At new developments and/or re-developments of existing shopping centers, some tenants will include a construction commencement or delivery of possession co-tenancy requirement. The intent of this type of co-tenancy is to identify co-tenancy risks earlier than the rent commencement date, at which point the tenant will have incurred significant dollars building-out its premises and preparing to open its store. A construction commencement or delivery of possession co-tenancy requirement usually will require the landlord to have a certain number or leases executed and/or leases executed with specific tenants, which tenants' premises shall either be delivered to such tenants and/or are under construction. If the construction commencement or delivery of possession co-tenancy requirement is not satisfied, then the delivery of possession may be delayed until it is satisfied and/or at some point the tenant may have the right to terminate the lease. Some tenants will ask for a reimbursement of costs into the deal if the lease is terminated as a result of a construction commencement or delivery of possession co-tenancy failure.

While co-tenancy clauses are designed to protect tenants' interests, landlords often include terms in the co-tenancy clauses to balance the respective interests of the parties. As I mentioned earlier, the landlord is not a surety. The landlord should not be expected to protect the tenant from all co-tenancy risks and under all circumstances. For example, if the tenant is in default of its lease at the time the co-tenancy failure occurs, is it equitable for the tenant to be entitled to its co-tenancy remedies? Similarly, if the tenant is not open and operating its business at the premises, is it fair for the tenant to pay reduced rent as a result of a co-tenancy failure? Landlords will often condition that a tenant's co-tenancy rights are conditioned upon the tenant not being in default under the lease and otherwise open and operating its business in the premises (excluding permitted closures)

Summary of Critical Components included in a Co-tenancy Clause

As noted above, while property and deal specific facts will impact how co-tenancy provisions are drafted and negotiated, the following summarizes items that generally should be considered when drafting a co-tenancy clause.

1. Leased Area Requirement

- a. Clearly define the gross leasable area ("GLA") and specify what is excluded from the numerator and denominator of the GLA requirement:
 - The Premises
 - Kiosks/carts
 - Department stores/key stores
 - Non-retailers, such as professional offices, banks, salons
 - Restaurants, movie theaters and other types of occupants
- b. Specify a minimum GLA of the shopping center for purposes of the denominator
- c. Specify whether department store space that is redeveloped into small shop space should be included in the GLA requirement noting that flexibility will be key to long term success of the shopping center industry

2. Key Store/Department Store Requirement

- a. Specify the tradename, approximate GLA and location of each required department store/key store
- b. If less than all department stores/key stores are required (e.g., 4 of 6), specify what happens to any extras (e.g., are they included in the GLA requirement or not counted at all) using objective standards (e.g., the "largest open" key stores or the key stores that are "open and closest" to the premises)

3. Certification/Audit Rights

- a. Require the landlord to certify whether the co-tenancy requirements are met and provide supporting documentation upon request
- b. Require the landlord to notify the tenant when a co-tenancy failure is cured and provide supporting documentation
- c. Expressly permit a co-tenancy audit by the tenant

4. Alternative Rent/Reduced Rent Remedy

- a. A retailer will want to specify that rent shall be automatically converted to alternative rent upon a co-tenancy failure, not upon Tenant's election or notice
- b. Permit alternative rent to apply retroactively to the date on which the co-tenancy violation first occurred
- c. Landlord's will want a "fish or cut bait" mechanism built into the clause wherein after a specified period of paying reduced rent, a Tenant must elect to either resume the payment of full rent or terminate its lease.

5. Termination Remedy

- a. Permit payment of alternative rent until the effective date of the termination
- b. Retailers will want to state that the landlord cannot nullify the termination by curing the co-tenancy failure (since it is difficult for most retailers to reverse course once employees are notified and merchandise orders are stopped)
- c. Re-instate the termination remedy if the co-tenancy failure occurs within 4 months of being cured

6. Sunset Provisions/Expiration of Remedy Prior to Cure

- a. To activate the sunset, require the landlord to terminate unless the tenant returns to full rent within 30 days after receipt of termination
- b. If the co-tenancy remedies expire after a certain period, re-instate the remedies if the co-tenancy violation continues for an additional year or if less than 50% of the total GLA of the shopping center (including key stores/department stores but excluding the Premises) is open
- c. In consideration for permitting a sunset to the termination right, delay the sunset until 30 days after the landlord notifies the tenant of the date on which the co-tenancy violation first occurred (to prevent the tenant from unknowingly losing a termination right)

7. Excused Closure

- a. Specify that any waiting period (before which co-tenancy remedies may be exercised) runs concurrently with any excused closure due to remodeling or repairs.
- b. Determine if force majeure closures, such as closures due to a virus, are included a excused closures.

Post COVID-19 World

Prior to the COVID-19 pandemic, retail landlords and tenants were facing an uncertain economic environment. The great recession caused many retailers to cease business operations and the retail industry was working to reinvent itself. Restaurant, fitness, entertainment and recreation operators began to replace many of the soft goods and apparel retailers that typically occupied traditional shopping centers. Unfortunately for the retail real estate industry, these types of operators were some of the hardest hit business categories by the COVID-19 pandemic because their businesses require the gathering of groups of people, often in large numbers and at the same time, in confined indoor spaces. As we enter into a post COVID-19 world landlords and tenants should consider the following:

1. Review the co-tenancy clause and definition of force majeure in all leases.
 - Landlords and tenants should develop a systematic process for reviewing the co-tenancy clauses and force majeure provisions in all of their leases. Some old leases do not include a definition for force majeure, even though the concept is referenced in the lease (just undefined).
2. Should an interruption of business caused by a virus be deemed a force majeure delay?
 - It may seem intuitive to some that a global pandemic is certainly a circumstance outside of a landlord's control, and consequently, constitutes a force majeure event, nonetheless, it is prudent not to leave this up to interpretation.
 - From a landlord's perspective, it is preferred for a co-tenancy clause to include an exception when the co-tenancy failure is caused by temporary closures outside of the landlord's reasonable control. Nonetheless, the general force majeure clause in a lease is intended to excuse a party that is prevented from performing as a result of circumstances outside of its control.
3. Should the landlord and tenant be obligations to inform the other party when a force majeure event exists? If so, what is a reasonable period of time after the force majeure event first exists within which such notice should be delivered?
4. If an interruption of business caused by a virus is deemed to be a force majeure delay, then should co-tenancy requirements in retail leases be tolled until the force majeure delay no longer exists?
 - Like most issues that have potential for a dispute, landlords and tenants are often better-off to discuss challenging issues up-front and agree upon their respective rights and remedies before the situation occurs.
5. How do we determine when the force majeure delay no longer exists?
 - Unlike other circumstances outside of the landlord's and tenant's control, when an interruption of business caused by a virus ceases is less clear. Landlords and tenants should consider including a clear definition in their leases as to when a force majeure event as a result of a virus no longer exists.

6. Should there be a time period after the force majeure delay no longer exists for tenants to reopen before a co-tenancy violation can be claimed?
 - Landlords and tenants will need to determine what is equitable under the circumstances.
7. Should landlords be given additional time to replace a co-tenant that goes out of business or closes due to extraordinary circumstances, such as a global pandemic?
 - Should landlords and tenants acknowledge that all force majeure events are not equal, and consequently, should be not treated the same? Does a force majeure event caused by a virus that results in a co-tenant ceasing business operations warrant different treatment than a cessation of business caused by a casualty?
8. Given the acceleration of changes in the retail industry, do landlords and tenants need to re-evaluate the purpose of co-tenancy provisions and adapt them to the changed circumstances now existing in the industry, such as changes to the tenant mix of shopping centers and how that may impact the agreed upon criteria for replacement tenants?