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Peer to Peer 5

**THE EVOLUTION OF EXCLUSIVE AND PROHIBITED USES
IN A CHANGING RETAIL LANDSCAPE**

Nicholas Dierman

West Coast Divisional Counsel
Federal Realty Investment Trust
830 S. Pacific Coast Hwy., Ste 204
El Segundo, CA 90245
ndierman@federalrealty.com

Margaret Petersen

Principal
Petersen Law PLLC
2603 Geddes Avenue
Ann Arbor, MI 48104
margaret@petersenlawpllc.com

SESSION OUTLINE

- I. Introductions
- II. Prohibited Uses
 - A. Landlord Concerns
 - 1. Flexibility of Leasing
 - 2. Future proofing / ability to adapt to shifting market conditions
 - 3. Overbroad language requiring constant approval requests
 - B. Tenant Concerns
 - 1. Parking
 - 2. Obnoxious uses / undesirable co-tenants
 - 3. Reputation and first-class nature of Center
 - C. Compromises
 - 1. Agreement on truly noxious and offensive uses
 - 2. Trend away from office/residential/educational bans
 - 3. Carveout language for first-class uses
- III. Exclusive Uses
 - A. Landlord Concerns
 - 1. Flexibility of Leasing
 - 2. Separating direct competitors from merely similar uses
 - 3. Limiting remedies and dealing with “rogue” tenants
 - B. Tenant Concerns
 - 1. Protecting business and gross sales (should be a LL concern, too!)
 - 2. Ensuring remedies do not allow LL to strategically and intentionally violate and get a slap on the wrist
 - 3. Protecting areas of future growth
 - C. Compromises
 - 1. Exclusive use “zones” versus entirety of Center, if applicable
 - 2. List of named competitors and named non-competitors

DESCRIPTION OF SESSION

The retail landscape of 2021 is remarkably different from the once-familiar world of enclosed shopping malls and big-box centers that dominated the 1980s and 1990s. Bookstores are rare and video and record stores even rarer; fashion retailers are fewer and the traditional department store anchor is endangered – yet we are often still drafting new leases and shopping center REAs (and the like) with prohibited and exclusive use language and restrictions that have changed little, if at all, in decades.

In this peer-to-peer session, we will look at:

- Prohibited uses – does the standard roster of “non-retail no-nos” still apply? Medical, educational and office uses are now common even in upscale shopping centers; should traditional retailers still care – and why? In 2021, marijuana is a booming business and its federal legalization seems like an inevitability – so why do prohibited use clauses still treat marijuana uses as obnoxious? Should they?
- Exclusive uses – as retailers learn to adapt to rapidly shifting conditions, they’ve shaken up their merchandising and evolved what they sell. Meanwhile, new and exciting concepts in retail such as food halls, apparel “showrooms” without inventory, and micro-fitness boutiques don’t quite fit into traditional exclusive use paradigms. What should tenants be looking out for as they draft new exclusive use clauses, and what should landlords insist be carved out?

FACT PATTERN 1(A)

Entire Foods Marketplace (“EFM”) is an anchor in a thriving outdoor lifestyle center with multiple restaurant concepts. EFM has a broad and restrictive exclusive use clause which prohibits any other retailer at the center from selling groceries, defined as the sale for off-premises consumption of any of the following: fresh produce, fresh meat, fresh poultry, fresh seafood, dairy, cheese, cereals, grains, frozen foods, prepared foods, grocery products, bulk foods, and alcoholic beverages.

At the beginning of the COVID-19 pandemic, the jurisdiction where the center is located shut down all restaurants for onsite dining. One of the restaurants, Acme Restaurant, decided to pivot to a temporary “general store” concept, selling produce, fresh meat and poultry, pantry staples and toilet paper to customers to meet community needs.

The owner of the center, Lifestyle Development Co., has been made aware that Acme is not operating pursuant to the permitted use clause of its lease. Lifestyle’s counsel has been tasked with deciding whether to enforce the permitted use clause against Acme.

QUESTIONS FOR FACT PATTERN 1(A):

- 1. Would you advise Lifestyle to permit Acme to temporarily operate as a general store, or would you advise Lifestyle to enforce the permitted use clause in Acme’s lease?**
- 2. If Lifestyle chooses to look the other way, is Lifestyle violating its lease with EFM by permitting Acme to temporarily operate as a general store?**
- 3. If you are counsel for EFM, would you invoke the exclusive use clause of EFM’s lease with Lifestyle?**
- 4. What are some ways that attorneys can draft future leases to permit flexibility for merchandising in temporary situations such as this one?**

FACT PATTERN 1(B)

EFM’s parent company, internet giant Nile.com, has been developing new proprietary cashier-less checkout technology and is insisting that all future EFM leases contain the exclusive right to a cashier-less checkout system. Lifestyle wants to do another lease with EFM at a new development, but Nile.com is insistent that the exclusive use clause also operate to prohibit Lifestyle from leasing to any other tenant with cashier-less checkout technology.

QUESTIONS FOR FACT PATTERN 1(B):

- 1. Representing Lifestyle, what reasons would you give for pushing back on this exclusive use?**
- 2. Representing EFM and Nile.com, what reasons would you give for requiring this exclusive use?**

FACT PATTERN 2

You are negotiating a new lease in a big-box center with a large national off-brand apparel retailer, Schloss Dress Cheaper. Schloss insists on using its own form, which contains a lengthy list of prohibited uses which was first drafted in 1986 and has not been updated since.

Among other uses, Schloss's lease prohibits the Landlord from leasing to: "schools or educational facilities," "flea markets," "veterinary services or dog boarding kennels," "massage parlors," "bowling alleys," "skating rinks," "the sale of motor vehicles," "laundromats or laundry facilities," and "the sale of marijuana, cannabis products or paraphernalia associated with marijuana and cannabis products."

The center has undergone a recent redevelopment and expansion which includes a large common area, a hotel, and an upscale apartment building.

QUESTIONS FOR FACT PATTERN 2:

- 1. Assuming you do not strike Schloss's language entirely, what carve-outs would you make to each of the prohibited uses listed above to ensure that the center could adapt to existing and future retail conditions?**
- 2. Let's assume the above prohibited uses were not negotiated and a lease was signed. Would you advise the landlord's leasing agent and operations managers to proceed with the following *without* Schloss's consent? And if so, why?**
 - a. A lease with Kumon, Kaplan, Code Ninjas or a similar tutoring school?**
 - b. A lease with Massage Envy?**
 - c. A lease for a Tesla showroom?**
 - d. A lease with PetSmart which includes its veterinary and boarding facilities?**
- 3. Should the Landlord be concerned that the apartment building contains a laundry facility on the ground floor? What if Landlord's marketing team wants to construct a seasonal ice skating rink in the common area plaza between the hotel and the retail portion of the center?**

FACT PATTERN 3

Gigando Mall is an enclosed mall that was developed in the 1960s in a traditional center court, four small shop “wings,” and department store anchors at the end of each “wing” format. The mall is owned in fee by a single owner (Gigando Owner, not the original developer), although one of the department store parcels (including some parking field area) is owned by the department store company, Spheres. The entire mall is encumbered by a COREA document to which the shopping center owner (as successor in interest) and the department store owner are parties. Spheres is in the process of closing most of its remaining department stores nationwide, and two of the other department stores are operating in the red, so closure of one or both is likely.

The COREA includes the following provisions:

- Spheres covenants to operate as a “department store”, defined as “a retail establishment offering a wide range of consumer goods in different areas of the store, each area (“department”) specializing in a product category”.
- Gigando Owner covenants to operate the Gigando Mall a “shopping mall”, defined as “a retail complex containing a variety of stores and restaurants and other business establishments commonly found in shopping centers”.
- A list of “prohibited uses” that includes cinemas or theaters, places of entertainment (including arcades, game rooms), places of recreation (including gyms, bowling alleys, billiards, skating), offices, professional uses (including medical and dental uses), schools or places of instruction, “outlet” stores, and residential uses. None of the foregoing is prohibited by local zoning.

Gigando Owner, Spheres, and the two operating-in-the-red department stores are in conceptual agreement that the mall needs to be renovated and redeveloped. The fourth department store is willing to go along with redevelopment but has concerns about opening up the permitted uses to include uses that are on the prohibited uses list. Spheres wants to subdivide its building into smaller premises that may include non-retail uses and perhaps even residential. The two operating-in-the-red department stores are thinking along the same lines. The various mortgagees of the parcel owners are willing to consider consenting to major property renovations and redevelopment but, being risk averse, have no appetite for law suits given the COREA’s limitations.

You are one of the lawyers (among several) that is being consulted to think “Big Picture”, “Next Steps”, and “How to Redevelop the Entire Mall Property”, including dealing with the use restrictions and the operating use requirements.

QUESTIONS FOR FACT PATTERN 3:

1. **What are your considerations and next steps as to either amending (in part) or amending and restating a COREA-type document, among other things to modify a prohibited uses list that no longer makes sense for the encumbered property? What party or parties may need to agree in writing to any such change? What if the COREA is silent as to any provisions describing how and who may amend the COREA?**
2. **What are your considerations for modifying required uses as well as updating specific COREA-type use restrictions for a “Gigando Mall” setting? What about in a long-term space lease or ground lease – same considerations? Do you take into account the rights or potential claims of the in-line tenants (or other major tenants) who are not parties to the COREA-type document, and what are your considerations for doing so or not doing so?**
3. **If a Gigando Mall redevelopment (a “re-imagining” of a mall) includes opening the door to non-retail uses, including office, residential, hotel, service / professional, and entertainment uses (among others), then what is left to prohibit or restrict? What are your drafting considerations for the future to take the property into the next 50 years?**