

**Wednesday, October 23, 2019  
3:30 PM – 4:45 PM**

**Seminar 4**

**(Br)Exit Strategies for Leases – Anticipation, Negotiation, Deal or No Deal – Avoiding an Impasse**

Presented to  
**2019 U.S. Shopping Center Law Conference  
Marriott Marquis San Diego Marina  
San Diego, CA  
October 23-25, 2019**

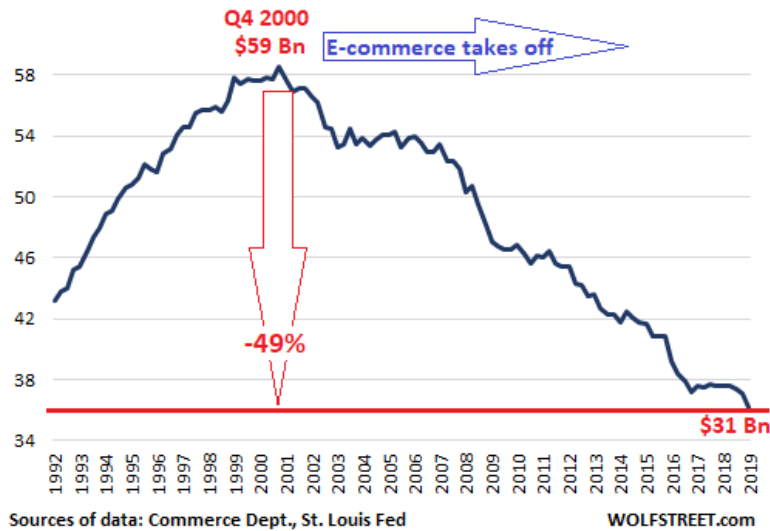
**David P. Vallas**  
Shareholder/Practice Vice Chair  
Polsinelli PC  
150 N. Riverside Plaza  
Suite 3000  
Chicago, IL 60606  
[DVallas@Polsinelli.com](mailto:DVallas@Polsinelli.com)

**Matthew Bordwin**  
Principal and Managing Director  
Keen-Summit Capital Partners  
LLC  
1 Huntington Quad  
Suite 2C04  
Melville, NY 11747  
[MBordwin@Keen-Summit.com](mailto:MBordwin@Keen-Summit.com)

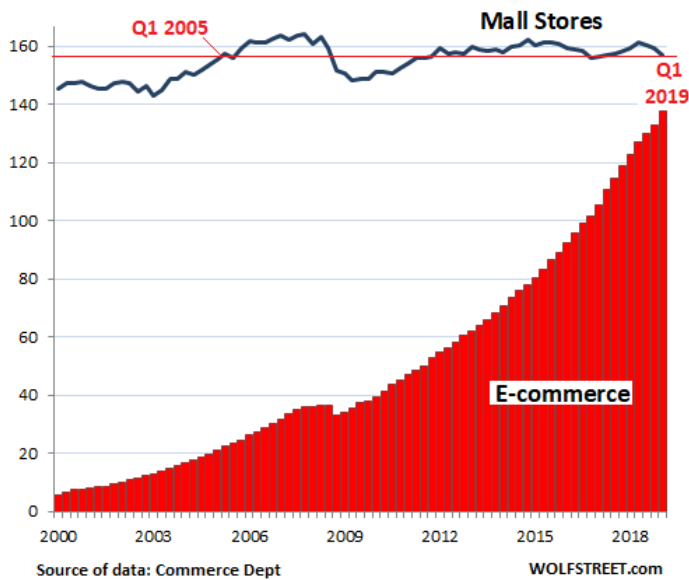
**John H. Lewis**  
Senior Counsel  
Hartman Simons & Wood LLP  
6400 Powers Ferry Road, NW  
Suite 400  
Atlanta, GA 30339  
[John.Lewis@hartmansimons.com](mailto:John.Lewis@hartmansimons.com)

Retailers and shopping centers alike often have reason to terminate commercial leases, particularly in the unsettled current retail climate. Corporate cutbacks, disappointing retail sales, and a changing marketplace as online retailers like Amazon continue to penetrate shopping habits are but a few of these reasons. Department store sales are at 20-year low and e-commerce spending has steadily and quickly risen.

### The 20-Year Plunge to New Low Department Store Sales, billion \$, quarterly



### E-commerce v. Mall Stores, Sales, \$ Billions Not adjusted for inflation!



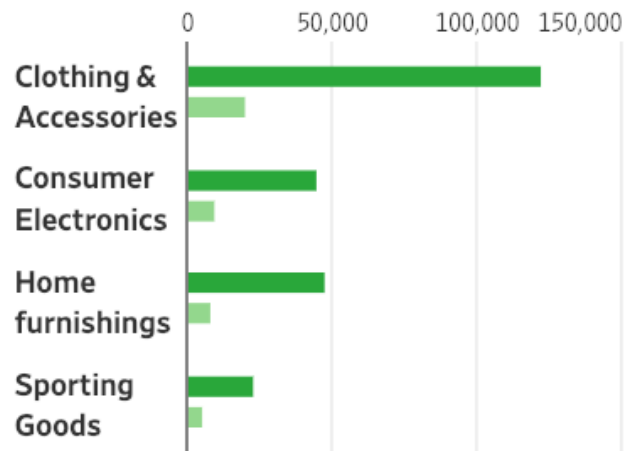
Source: "E-commerce Crushes Mall Retailers One by One. Here's the Data," *Wolf Street*, May 18, 2019

Business Insider reported in May, 2019 that retailers have announced 6,400 store closures through the first part of 2019, more than in all of 2018. Against this loss, 2,264 new stores are slated to open, the majority of which – Dollar Tree, Dollar General and Family Dollar – sell the cheapest of all merchandise. If online retail sales continue to penetrate the market, the projected number of retail store closings by 2026 is expected to continue:

## Everything Must Go

U.S. retailers are projected to close thousands of stores as e-commerce penetration continues to grow.

- Number of stores as of 3Q 2018
- Estimated closures between



Source: UBS

Retailers with more than 50 locations scheduled to close in 2019 include many household names.

Payless ShoeSource	2,500
Gymboree	805
Dress Barn	650
Charlotte Russe	520
Family Dollar	390
Shopko	371
Fred's	263
Chico's	250
Gap	230
Things Remembered	200+
Ascena Retail Group	200
LifeWay Christian Stores	170
Signet Jewelers, parent company of Jared: The Galleria of Jewelry and several other jewelry chains.	150
Starbucks	150
Pier 1 Imports	Up to 145
Performance Bicycle	102
Sears	70
Destination Maternity	Up to 67
Victoria's Secret Stores	53
Lowe's	51

Source: American Bankruptcy Institute; "More than 7,000 stores are closing in 2019 as the retail apocalypse drags on — here's the full list," *Business Insider*, May 21, 2019; "These Chains Have Announced a Ton of Store Closings in 2019," *MoneyWise*, 5/27/2019

Vacancy is as high as it has ever been in top luxury submarkets like Chicago's North Michigan Avenue and 5<sup>th</sup> Avenue in New York City.

Anchor stores once were the big draw bringing foot traffic into shopping centers. Big box vacancies are at an all-time high, however. Moreover, some smaller brands that historically drew shoppers to shopping centers are shrinking their footprints and instead are focusing on flagship stores, especially those in high-performing malls.

Shopping center owners and managers have responded to these changes by filling some empty spaces with huge fitness clubs, rock-climbing gyms, and other on-site experiences, changing the traditional notion of a shopping center. Some malls are converting large empty spaces into warehouses to strengthen Amazon's supply chain and physical position, or to office, medical or other uses. Duke University recently purchased a 183,840 square-foot building in Northgate Mall that will become the largest Duke Health clinic off the main hospital campus. The two-story building—previously a Macy's department store that closed in early 2017—will house administrative offices and patient clinics for Duke Health. WeWork recently purchased Lord & Taylor's iconic 5th Avenue flagship store to redevelop into office space.

For their part, shopping center owners may want to replace an existing retailer with “more desirable” tenant as part of this evolution. Beyond just a need for a strong tenant that is resistant to e-commerce, landlords are looking for tenants that enhance the shopping center experience: movie theaters, miniature golf, bowling, rock climbing walls, gyms/fitness centers, cooking classes, to name a few. A landlord presented with an opportunity to lease to a desirable new tenant may only be able to take advantage of that opportunity if an “old” tenant is removed completely or moved to another location.

The confluence of these events and the change of the shopping center experience is resulting in more and more retailers and shopping center owners looking to exit their leases.

## **I. General Considerations for Lease Terminations**

Economics drive most negotiations for the right to terminate a retail lease, whether those negotiations arise in connection with the initial lease itself or years down the line when a landlord or tenant is looking to exit its lease. Retailers often consider the cost of the improvements they made to the leased space and the equipment and other personal property that may remain in the premises after the tenant exits. They try to position these improvement and personal property as a benefit to the shopping centers that enhance the value of the space and make it more desirable to a replacement tenant. Shopping center owners look to the costs they incurred for the benefit of the retailer – the cost of any work that the landlord did to prepare the space for the tenant, any Tenant Allowance paid to the retailer for its improvements, and the brokerage and legal expenses incurred – as well as the expected lost income stream from a terminated lease.

## **II. Unilateral Right to Terminate the Lease**

In some circumstances, the parties will negotiate up front the right of one party or the other, or both, to terminate without any particular cause. For example, a landlord may have potential alternative plans for the center, or a tenant may see itself outgrowing the available space in this center (or wanting to close or relocate elsewhere), so the parties may negotiate a termination right to preserve flexibility for those possibilities. In the example that follows, the tenant has obtained the right to terminate within specific period of time; alternatively a termination right might be exercisable within a specified “window” in the future.

### **EXAMPLE 1 (Unilateral Termination):**

Tenant shall have the one-time option to terminate this Lease prior to the Expiration Date of the initial Term upon the conditions stated below. This “**Termination Option**” shall be void unless exercised precisely according to these conditions:

(a) Tenant shall exercise this Termination Option by written notice (the “Termination Notice”), which must be received by Landlord not later than the last day of the \_\_\_\_\_ (\_\_\_\_) month of the Lease Term. If the Termination Option is duly and timely exercised in strict accordance with this Section \_\_, such Termination shall be effective as of the last day of the \_\_\_\_\_ (\_\_\_\_) month of the Lease Term (the “**Termination Date**”).

(b) No Event of Default by Tenant beyond any applicable notice and cure period of any of the provisions or conditions of this Lease shall exist at the time of Termination Notice, and for the remainder of the Term through the Termination Date.

(c) Tenant shall pay to Lender a termination fee in an amount equal to the sum of all unamortized Tenant concessions paid by Landlord regarding this Lease including, without limitation, any Brokers' commissions, leasehold improvement costs, the Reimbursement Allowance, and Abated Rent, such costs to be amortized over the initial Term of the Lease at an interest rate of \_\_\_\_\_ percent (\_\_\_%) (collectively, the "**Termination Fee**"). Tenant shall pay (i) fifty percent (50%) of the Termination Fee to Landlord simultaneously with the delivery of the Termination Notice and (ii) fifty percent (50%) of the Termination Fee to Landlord not later than thirty (30) days prior to the Termination Date.

(d) Tenant shall continue to pay all Base Rent and all other amounts due pursuant to the Lease as they come due under the Lease. If at any time after the delivery of the Termination Notice Tenant fails to timely make any of such payments on a timely basis and a default or event of default beyond any applicable notice and cure period exists, this Termination Option and Tenant's exercise of the same shall become null and void and be of no further effect.

(e) Tenant shall continue to be fully liable after the Termination Date for Tenant's financial obligations accruing through the Termination Date (including, without limitation, rents and charges identified above and other costs, if any), and Tenant shall pay all amounts in full within twenty (20) calendar days of the date of receipt of Landlord's invoice(s) therefor.

(f) TIME IS OF THE ESSENCE OF THIS TERMINATION OPTION. This Termination Option applies to Tenant only, and shall be void if (i) Tenant fails to exercise it precisely according to each and all of the conditions stated above, or (ii) if Tenant assigns the Lease or sublets the Premises or otherwise transfers all or part of its interest in the Lease or the Premises, except for a Permitted Transfer.

An alternative to a landlord's unilateral right to terminate a lease is the right to relocate a retailer to another premises within a shopping center. Landlords generally like to keep their options open with a relocation of premises clause. Some landlords prefer that a tenant terminates its lease and vacates the shopping center altogether rather than having to pay tenant allowance to relocate the tenant to another part of the center, particularly if the stability of the retailer is uncertain or the income doesn't justify the cost. An example of a relocation provision is:

**EXAMPLE 2 (Relocation):** Landlord reserves the right at any time during the Term to change the location of the Premises upon thirty (30) days' prior written notice to Tenant. Landlord shall offer to Tenant an alternative location (the "**Relocation Space**") in the Shopping Center that is comparable in all material respects to the Premises. Landlord, at Landlord's cost and expense, shall complete the leasehold improvements to the Relocation Space in accordance with the working drawings originally approved by Landlord with respect to Tenant's Work (as defined in Section \_\_\_\_ below) in connection with Tenant's initial occupancy of the Premises. Landlord shall reimburse Tenant for the reasonable actual out-of-pocket costs Tenant incurs which are directly related to such relocation, which costs shall be for moving, changing stationery and relocating telephone equipment. Such reimbursement shall be made within thirty (30) days after Tenant provides Landlord with sufficient evidence of such costs. Tenant shall open for business in the Relocation Space within fifteen (15) days after delivery to Tenant. If the parties agree on the Relocation Space, then Landlord and Tenant shall promptly enter into an agreement modifying this Lease only with respect to the description of the Premises and the Minimum Rent and all other items of rent which this Lease expressly states are calculated on a per square foot basis. If the Relocation Space is substantially comparable in all material respects to the Premises but Tenant refuses to relocate thereto, then Landlord may terminate this Lease upon delivery to Tenant of a written notice ("**Termination Notice**") terminating this Lease, and neither party shall have any further liability to the other. Tenant shall vacate the Premises within thirty (30) days after receiving the Termination Notice. Tenant shall deliver possession of the Premises to Landlord, within fifteen (15) days after the date Tenant opens for business in the Relocation Space, in the condition required pursuant to this Lease and subject to all charges which are due and owing or which shall accrue up to such date (which charges shall be paid to Landlord within thirty (30) days after such date). From and after the date Tenant takes possession of the Relocation Space, any and all references in this Lease to the Premises shall be deemed to be references to the Relocation Space.

Some landlords also negotiate the right to terminate a retailer's lease in the event the retailer proposes an assignment of its lease or to sublet the premises.

**EXAMPLE 3 (Early Termination Upon Request for Assignment/Subletting):** Upon receiving a request from Tenant for consent to a proposed assignment or subletting, Landlord, at its sole option, may elect to terminate this Lease by giving written notice to Tenant within thirty (30) days following receipt of the request for consent from Tenant stating its election. Should Landlord so elect, this Lease, and all of the obligations of the parties thereunder, shall terminate on the later to occur of sixty (60) days following Landlord's notice to Tenant of its election hereunder, or the effective date of the proposed assignment or subletting sought by the Tenant, but in no event later than one hundred twenty (120) days following the date of Landlord's election under this Section. At the time of termination, all obligations of both parties hereunder shall terminate as to obligations thereafter accruing. The purpose of this paragraph is to permit Landlord, at its sole option, to terminate this Lease, and relieve Tenant of its continuing liability in event of a proposed assignment or subletting. The original purpose of this Lease is the transfer of a right of possession to the Premises to Tenant. The parties acknowledge that the Tenant's right to assign or sublet does not go to the essence of this Lease.

A retailer may have a unilateral right to terminate its lease as well, typically if the retailer's sales dip below a certain threshold or there is a change in the tenant mix at the shopping center.

**EXAMPLE 4 (Gross Sales Kickout):** So long as Tenant is open and operating as a typical \_\_\_\_\_ store and is not in default beyond any applicable cure period, in the event that Tenant's Gross Sales during the Third (3<sup>rd</sup>) Lease Year do not exceed \$\_\_\_\_\_.00 (the "**Gross Sales Threshold**"), Tenant may terminate this Lease by giving Landlord sixty (60) days prior written notice following the end of the third (3<sup>rd</sup>) Lease Year. Tenant must deliver a certified statement of its Gross Sales (as defined herein) to Landlord at the time Tenant delivers such termination notice. Termination of the Lease under this Section \_\_\_\_\_ shall be effective on the thirtieth (30<sup>th</sup>) day after such notice is received by Landlord (the "**Termination Date**").

In addition and as a condition precedent to such termination, Tenant shall reimburse Landlord for (a) the unamortized brokerage commission payable under this lease, plus (b) the unamortized portion of the Tenant Allowance (collectively, the "**Termination Payment**"). Such amounts are to be amortized on a straight line basis over the initial term of the Lease. The Termination Payment must be made on or before the Termination Date, failing which any attempted exercise of the foregoing termination right shall be null, void and of no force or effect. Landlord and Tenant agree that the Gross Sales Threshold shall be proportionately reduced for any day on which Tenant would normally have been open that Tenant is not open during the 3<sup>rd</sup> Lease year.

Both parties hereby agree that any change in Tenant's Trade Name shall nullify Tenant's Kickout right under this Section \_\_\_\_\_.

**EXAMPLE 5 (Co-Tenancy Kickout/Opening Co-Tenancy):** Notwithstanding anything to the contrary contained herein, Tenant will not be required to initially open Tenant's Store Building to the public for business unless at least (i) two (2) other Major Stores and (ii) Shopping Center Tenants occupying at least seventy percent (70%) of the Gross Leasable Area of the Shopping Center are open for business to the public, nor under any circumstances shall Tenant be required to initially open Tenant's Store Building for business to the public during the Blackout Period.

**EXAMPLE 6 (Co-Tenancy Kickout/Opening Co-Tenancy):** Until (a) XYZ, or a single user equivalent replacement, is open for business containing approximately \_\_\_\_\_ square feet and is located as shown on Exhibit A; and (b) at least \_\_\_\_% of the Relevant GLA ("GLA" is herein defined as gross leasable area of the entire Shopping Center, Relevant GLA is defined below) is occupied by Retail Stores (as defined below) which are open for business; and (c) of the minimum \_\_\_\_% of the Relevant GLA that is required to be open and operating, \_\_\_\_ (\_\_\_\_) of the following \_\_\_\_ (\_\_\_\_) named retailers must also be open and operating: \_\_\_\_\_ (the "Opening Co-Tenancy Requirement"), Tenant shall have the option of (i) delaying its opening and the Term of the Lease shall not commence until all such requirements are met, or (ii) opening for business, in which event, the Initial Lease Term shall commence on the date Tenant so opens and Tenant shall pay, in lieu of all Rents and Other Charges otherwise payable under this Lease, the lesser of (x) the Minimum Rent, or (y) \_\_\_\_\_

percent (\_\_\_%) of Gross Sales, as defined in Section \_\_\_\_ ("Alternative Rent"), until the satisfaction of the terms and conditions of this Section 1.1.

As used herein, "Relevant GLA" shall mean the total GLA of the Shopping Center, excluding the XYZ space and the Leased Premises. "Retail Stores" shall mean retail stores and restaurants of the type typically found in first-class shopping centers in the geographic area where the Shopping Center is located, engaged primarily in the sale of goods, services, and food at retail, which operate seven (7) days per week. Retail Stores shall exclude, without limitation, the following: hair salon, health club or gym, post office, office space of any kind, bowling alley, seasonal rentals, closeout or liquidation-type operations, second-hand or thrift store, or any other tenant which sells goods at retail only as an incidental use. Notwithstanding the foregoing, a full service spa and salon or a salon that is incidental to another retail use shall be permitted.

The terms and conditions of this Section \_\_ shall not be deemed to have been complied with until such time as notice certifying same by Landlord has been received by Tenant. Such notice shall set forth the GLA of the Shopping Center, the GLA of each store open for business in the Shopping Center and the opening date thereof, and shall include a site plan designating the stores open for business.

In the event that the terms and conditions of this Section \_\_\_\_ shall not have been met within eighteen (18) months from the earlier of either: (a) the date Tenant opens for business in the Leased Premises, or (b) the date Tenant would have otherwise been required to open for business but for the provisions of this Section \_\_\_\_, Tenant shall have a one time-right right, which must be exercised within thirty (30) days following the end of the 18-month period, to terminate this Lease and vacate the Leased Premises, in which event this Lease shall automatically terminate on the 60<sup>th</sup> day following Landlord's receipt of Tenant's termination notice, and thereafter this Lease shall be null and void and of no further force and effect, and neither party hereto shall have any further obligation hereunder, except for such matters that are designated to survive the termination hereof. If Tenant does not elect to terminate this Lease in a timely manner as set forth above, then upon the 31<sup>st</sup> day following the end of such 18-month period, Tenant's right to terminate this Lease in accordance with Section \_\_ shall be null and void and Tenant shall commence payment of full Rent owed hereunder.

**EXAMPLE 7 (Operating Co-Tenancy/Reduction in Rent and Immediate Termination):** If, at any time during the TERM, as the TERM may be extended, the \_\_\_\_\_ [INSERT ANCHOR TENANT FROM LOI TERMS] ("Co-Tenant") ceases to be open to the public, fully staffed, stocked and operating in not less than \_\_\_\_ square feet of the Shopping Center (except for temporary store closings not exceeding sixty [60] days for remodeling, alterations or restoration work or in connection with casualty not exceeding one hundred eighty [180] days) (a "Continuing Co-Tenancy Violation"), then for any period thereafter that the Continuing Co-Tenancy Violation continues: (i) Annual Rent and TENANT'S Proportionate Share of the Common Area Maintenance Costs, Insurance and Taxes will be abated by Fifty Percent (50%); and (ii) TENANT may terminate this Lease by notifying LANDLORD in writing, which termination will be effective thirty (30) days after the date of such notice. If TENANT terminates this Lease as set forth in this Section, this Lease will terminate the terms of this Lease will be of no further effect, except for those obligations which survive termination of this Lease. If TENANT elects to terminate this Lease pursuant to this Section, then LANDLORD shall reimburse to TENANT the Unamortized Reimbursement Amount within thirty (30) days from the date of such termination, which obligation shall survive termination of this Lease. The "Unamortized Reimbursement Amount" shall mean the unamortized portion (as of the date of termination) of the sums expended by TENANT as set forth in TENANT'S books and records for the design, permitting and construction of TENANT'S improvements in and to the PREMISES according to the Approved Plans and any subsequent leasehold improvements, with amortization to be on a straight-line basis over ten (10) years commencing upon the date of each applicable expenditure. The total sums expended by TENANT in performing TENANT'S design, permitting and construction of TENANT'S improvements in and to the PREMISES according to the Approved Plans and any subsequent leasehold improvements will be reflected in a written itemization provided by TENANT at the same time as TENANT'S termination.

**EXAMPLE 8 (Operating Co-Tenancy/Reduction in Rent, Opportunity for Landlord to Cure, and One-Time Future Termination Right):** Provided that Tenant (i) is not in monetary default of this Lease beyond the expiration of all applicable notice and cure periods and (ii) is open and operating for business in the Leased Premises (except if due to casualty, condemnation, force

majeure or remodeling which is being diligently pursued to completion), a “Operating Co-Tenancy Event” shall occur if for any reason: (a) XYZ, or a single user equivalent replacement department store, is not conducting business in the entire XYZ space as shown on **Exhibit A**, or (b) at least \_\_\_% of the Relevant GLA (excluding the XYZ space and the Leased Premises) is occupied by Retail Stores which are open for business; provided, however, that if an Operating Co-Tenancy Event results from (i) from a casualty or condemnation, the Operating Co-Tenancy Event shall not be deemed to occur until one hundred eighty (180) days after the date upon which XYZ (or its single-user equivalent replacement) ceases to conduct business or (ii) a remodeling or renovation, the Operating Co-Tenancy Event shall not be deemed to occur until sixty (60) days after the date upon which XYZ (or its single-user equivalent replacement) ceases to conduct business. Upon the occurrence of any Operating Co-Tenancy Event, Rent payments due hereunder (however defined) shall abate until the date that both the Operating Co-Tenancy Event has ceased to exist and Landlord has so notified Tenant. During the period of such abatement, Tenant shall pay monthly, in arrears, in lieu of all Rents and Other Charges otherwise payable under this Lease, \_\_\_ percent (\_\_\_%) of Gross Sales (as defined in Section \_\_\_), which for purposes of this Section 1.1 shall be deemed Alternative Rent.

In the event that Tenant has been paying Alternative Rent for eighteen (18) consecutive months hereunder as a result of an Operating Co-Tenancy Event, Tenant shall have the one-time right (with respect to that particular Operating Co-Tenancy Event) which must be exercised within thirty (30) days following the end of the eighteen (18) month period, to terminate this Lease and vacate the Leased Premises, in which event this Lease shall automatically terminate on the 60<sup>th</sup> day following Landlord’s receipt of Tenant’s written termination notice (and Tenant shall have the right to pay Alternative Rent up until the date of termination). If Tenant does not elect to terminate this Lease in a timely manner as set forth above, then upon the 31<sup>st</sup> day following the end of such 18-month period, Tenant’s right to terminate this Lease in accordance with this Section \_\_\_ (and that particular Operating Co-Tenancy Event) shall be null and void and Tenant shall commence payment of full Rent owed hereunder. The foregoing rights shall apply to any replacement stores for those noted in (a) and (b) above.

Tenant shall notify Landlord at any time of the date which Tenant believes to be the date on which an Operating Co-Tenancy Event has occurred (“Tenant’s Notice”), and in the event that Landlord fails to notify Tenant within thirty (30) days after receipt of Tenant’s Notice that Landlord disputes the date set forth in Tenant’s Notice, and Landlord fails to respond to Tenant after five (5) additional days following a second written notice provided by Tenant, the date set forth in original Tenant’s Notice shall be irrevocably deemed to be the date upon which the Operating Co-Tenancy Event occurred and Tenant’s rights hereunder shall be effective as of the date set forth in Tenant’s Notice. From time to time, Landlord agrees to promptly respond to inquiries from Tenant concerning the occupancy of the Shopping Center, including any particular premises.

Co-tenancy violations are not always as clear they seem at first. Courts evaluating co-tenancy provisions are faced with interpreting what it means to be a “similar” tenant, and whether only retailers – in the traditional sense – fit that role. See *RadioShack Corp. v. Azusa Pacific Univ.*, 2016 WL 3640370, B262107 (Ct. App. Cal. June 30, 2016) (a fitness center was a “similar” tenant as discounter Big Lots because the fitness center drove equal or better foot traffic to the shopping center and sold a small assortment of retail goods that were at least as good a quality as Big Lots’ merchandise.) See *Shoe Show, Inc. v. One-Gateway Assocs., LLC*, No. 1:10CV13, 2015 WL 5674876, at \*8 (M.D.N.C. Sept. 25, 2015) (a co-tenancy requirement that a women’s apparel retailer be replaced with a “similar major retailer” was ambiguous). Other courts have considered how percentage of occupancy should be calculated, particularly when the terms of a co-tenancy provision are ambiguous. See *Best Buy Stores, L.P. v. Manteca Lifestyle Center, LLC*, 859 F.Supp.2d 1138 (E.D. Cal. 2012) (finding that a co-tenancy provision was susceptible to at least two interpretations, and that the ambiguities in the co-tenancy provision must be resolved through extrinsic evidence); *Claire’s Boutiques, Inc. v. Brownsburg Station Partners LLC*, 997 N.E.2d 1093 (Ind. App. 2013) (occupancy was determined as the percentage of tenants, not the percentage of leased area).

### **III. Evaluating a Tenant’s Liability**

In the absence of a lease provision allowing a retailer to terminate its lease, a tenant is faced with negotiating its exit, which should always include evaluating the amount of the tenant’s liability. To evaluate a retailer’s liability for an early exit, shopping centers and retailers should look to the default provision of the lease. Most retail leases provide that, upon a retailer’s default, the shopping center may terminate the lease or terminate the retailer’s right to possession of the leased premises without terminating the lease. Whether the lease has been terminated dictates the shopping center owner’s remedy and the measure of the retailer’s liability. If a shopping center owner terminates



the retailer's right to possession of the leased premises without terminating the lease, the retailer's obligation to pay rent generally ceases, unless the lease provides otherwise. Virtually every retail lease provides that the obligation to pay rent continues, however, even if the retailer is dispossessed of the leased premises. When this provision is present, the retailer is required to pay rent every month until the lease expires, or at least until the lease is terminated, which typically occurs only once the shopping center secures a tenant to replace the retailer's occupancy and rental stream.

Most shopping center leases allow the landlord to terminate the lease altogether as well. Terminating the lease ends the retailer's periodic rental obligation, but generally converts the retailer's liability into a calculation of all damages caused by the retailer's breach of contract. When a retailer defaults and the lease is terminated, most retail leases specify that the defaulting retailer must pay accrued rent, plus additional damages according to one of three common formulas: the "fair market value" formula, the "worth at the time of award" formula, and a pure acceleration provision.

**EXAMPLE 9 (Fair Market Value Formula):**

(a) Landlord, in addition to other rights or remedies it may have, shall have the right, by written notice to Tenant, to declare this Lease terminated and the Term ended, in which event this Lease and the Term shall terminate with the same force and effect as though the date set forth in the notice of termination was the date originally set forth herein and fixed for the expiration of the then-current Term, and Tenant shall immediately vacate and surrender the Premises in accordance with Section \_\_\_\_\_. If Tenant fails to vacate the Premises, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in rent, enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying the Premises or any part thereof. Landlord may recover from Tenant the following:

- (i) any unpaid rent which has been earned at the time of such termination; plus
- (ii) The difference between the then present value of the aggregate Rent which would have been payable after the date of termination had this Lease not been terminated over the then present value of the fair market rental value of the Premises for the balance of the Term following such termination date, such present value to be discounted at a rate of \_\_\_\_ percent (\_\_\_%) per annum; plus
- (iii) Any other amount reasonably necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, specifically including without limitation, brokerage commissions and advertising expenses incurred in re-leasing the Premises, expenses of remodeling the Premises or any portion thereof for a new tenant, whether for the same or a different use, and any special concessions made to obtain a new tenant; and
- (iv) At Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law.

Courts generally enforce these types of provisions because they contemplate "perfect mitigation," meaning that they assume the shopping center replaces the defaulting retailer immediately at the then current market rental rate. If the current market rental rate is equal to or above the retailer's lease rate, the shopping center owner may not be able to recover any future rent.

**EXAMPLE 10 (Worth at the Time of Award Formula):**

(a) Landlord, in addition to other rights or remedies it may have, shall have the right, by written notice to Tenant, to declare this Lease terminated and the Term ended, in which event this Lease and the Term shall terminate with the same force and effect as though the date set forth in the notice of termination was the date originally set forth herein and fixed for the expiration of the then-current Term, and Tenant shall immediately vacate and surrender the Premises in accordance with Section \_\_\_\_\_, but shall remain liable for all obligations arising during the balance of the then-current Term as if this Lease had remained in full force and effect. If Tenant fails to vacate the Premises, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in rent, enter upon and take possession of the Premises and expel or remove Tenant

and any other person who may be occupying the Premises or any part thereof, without being liable for prosecution or any claim or damage therefor. Landlord may recover from Tenant the following:

- (i) The worth at the time of award of any unpaid rent which has been earned at the time of such termination; plus
- (ii) The worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus
- (iii) The worth at the time of award of the amount by which the unpaid rent for the balance of the Lease Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus
- (iv) Any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, specifically including but not limited to, brokerage commissions and advertising expenses incurred, expenses of remodeling the Premises or any portion thereof for a new tenant, whether for the same or a different use, and any special concessions made to obtain a new tenant; and
- (v) At Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law. The term "rent" as used in this Subsection \_\_\_\_ (a) shall be deemed to be and to mean all sums of every nature required to be paid by Tenant pursuant to the terms of this Lease, whether to Landlord or to others. As used in Subsections \_\_\_\_ (a)(i) and (ii) above, the "worth at the time of award" shall be computed by allowing interest at the rate specified in Section \_\_\_\_ hereof, but in no case greater than the maximum amount of such interest permitted by law. As used in Subsection \_\_\_\_ (a)(iii) above, the "worth at the time of award" shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of \_\_\_\_\_ at the time of award plus \_\_\_\_ percent (\_\_\_\_%).

This provision allocates damages over three periods of time. First, the defaulting tenant must pay the past due rent plus interest through the date that the court enters judgment. Second, the defaulting tenant must pay the rent that would have accrued from the date of termination of the lease through the date the court enters judgment, plus interest. Third, the defaulting tenant must pay the rent that would have accrued from the date of judgment through the end of the term, if the lease had not been terminated, discounted to present value. Credited against the amounts of lost rental for the period after termination of the lease is any loss that the defaulting tenant proves could reasonably have been avoided by the shopping center, which is generally the amount that a hypothetical replacement tenant would pay for the premises.

#### **EXAMPLE 11 (Acceleration):**

Acceleration of Future Rentals. Landlord, at its election, may demand to be indemnified for its loss of Rent (with respect to the period following such termination) by a lump sum payment equal to the entire amount of Rent that would have been paid in accordance with this Lease for the remainder of the Term. Landlord shall be entitled to recover from Tenant, and Tenant shall pay to Landlord, on demand, such amount as final damages for Tenant's default with respect to the Rents payable for the remainder of the Term as described above.

Some courts find these types of acceleration provisions unenforceable because they impose a more onerous obligation on the defaulting retailer than if it had fully performed *and* these provisions allow a shopping center owner to recover twice: once from the defaulting retailer and then again from any replacement tenant.

Regardless of whether a shopping center owner terminates a retailer's right to possession of the leased premises or terminates the lease altogether, the retailer will typically be liable for the actual costs and expenses incurred by the shopping center, including the costs of brokerage, the improvements to attract a replacement tenant, and the construction allowance paid to the new tenant.

#### **IV. Midnight Run?**

When considering an exit strategy, retailers are faced with the decision whether to close the store and vacate the premises and then negotiate an exit or to remain open and operating during this process. Closing a store prematurely without the landlord's consent may invalidate an otherwise enforceable right to terminate the lease that the parties negotiated and included in the lease itself. It may give rise to other liability as well.

**EXAMPLE 12 (Tenant's Covenant to Open and Operate; Failure to Do So is Default):** Tenant hereby acknowledges that Tenant's use of the Premises and ability to generate patronage to the Premises and the Shopping Center were all relied upon by Landlord and served as significant and material inducements contributing to Landlord's decision to enter into this Lease with Tenant. As such, Tenant agrees that, from and after the Rent Commencement Date, Tenant will continuously and uninterruptedly keep open and operate its business in the entire Premises fully fixtured, stocked, and staffed for the purpose specified in Section 1.1(k) and under the trade name specified in Section 1.1(a) with the public daily during such hours as are customary in the Shopping Center, subject to the terms and conditions of any franchise agreements with \_\_\_\_\_. Tenant's failure to operate as required by this Section shall be deemed an automatic Event of Default (without the requirement of any notice or cure period) under this Lease. If such an Event of Default occurs, then, for so long as neither this Lease nor Tenant's right to possession of the Premises under this Lease is terminated by Landlord, Tenant shall pay to Landlord on demand, in addition to the payment of all Rent (including, without limitation, Minimum Annual Rent) and other charges then due under this Lease and as Additional Rent hereunder, an additional amount equal to three (3) times the per diem Minimum Rent for each day during the period in which Tenant so fails to open for business. Such amount shall be considered additional rent due and payable hereunder due to the loss of traffic at the Shopping Center and percentage rent that may have been earned by Landlord during such period. Notwithstanding the foregoing, Tenant's payment of such amount shall not deprive Landlord of any other rights and remedies available to it hereunder, at law or in equity as a result of Tenant's Event of Default described herein.

**EXAMPLE 13 (Tenant's Covenant to Open For a Day; Failure to Do So is Not a Default):** Tenant agrees to fixture and stock the Building and to open the Building for business to the general public as a retail store under the trade name "\_\_\_\_\_" (or such other trade name under which Tenant's stores in \_\_\_\_\_ are then operated) for at least one (1) day on or before the later to occur of (i) \_\_\_\_\_, 20\_\_\_\_, or (ii) the date which is \_\_\_\_\_ (\_\_\_\_) months after \_\_\_\_\_. Any other provision of this lease to the contrary notwithstanding, however, Landlord acknowledges, covenants and agrees (x) that Tenant's failure to open for business as provided in this Section \_\_\_\_ shall not be a default under this lease, and (y) Landlord's sole right, remedy and recourse for Tenant's failure to open for business as provided in this Section \_\_\_\_ shall be as set forth in Section \_\_\_\_ hereof **[TYPICALLY A RECAPTURE PROVISION]**.

Giving advance notice of a retailer's plan to shutter stores and vacate leased premises may have other drawbacks as well. *Simon Property Group L.P. v. Starbucks Corporation*, No. 49D01-1708-PL-032170, 2017 WL 6452028 (Ind. Super. Nov. 27, 2017), addresses this precise situation. Starbucks reported its plan to close 77 Teavana stores in Simon-owned or managed properties. Before Starbucks closed any of those stores, Simon sought an injunction enjoining Starbucks from closing them. The court sided with Simon, finding that each of the Teavana leases contained a continuous operation provision and gave Simon the right to specific performance. Of equal importance, each Teavana store was open and operating at the time of the injunction. While courts are generally reluctant to compel a party to act in a certain manner, courts are more likely to maintain the *status quo*, which in the *Simon* scenario meant keeping the Teavana stores open.

In *Bellevue Square, LLC v. Whole Foods Market Pacific Northwest, Inc.*, 6 Wash. App. 2d 709 (Wash. Ct. App. Div.1 2018), the court concluded that the landlord could not force Whole Foods to re-open its shuttered store because the lease required the landlord to attempt to re-let the premises, such that the lease provided an adequate remedy to the landlord. The court did not specifically address the fact that the Whole Foods store had already closed, but this decision demonstrates the reluctance of courts to compel an already closed store to re-open.

## **V. Negotiated Exits**

Negotiated lease terminations take many forms depending on the circumstances. It is important for the parties to remember, whenever possible in negotiating a termination agreement, that in such circumstances landlords and tenants are on the same team or, at the very least, it is important for each party to recognize and give fair consideration to the legitimate concerns and business considerations that are driving the decisions of the other party.

Given the challenges facing brick-and-mortar retail today, it is important that landlords take store closure requests seriously, and it is equally important that tenants recognize the investment made by landlords and the losses that landlords face when retail tenants vacate space. In any given situation, of course, the landlord or the tenant may have greater leverage and that leverage will factor into the mix of contingencies, payments, penalties and other provisions within a negotiated settlement.

In drafting a termination agreement, care must be given to address any contingencies to the effectiveness of the termination, including those contingencies specifically negotiated for the particular situation. For example, the agreement will likely require the tenant to be current in the payment of all of its rent and other financial obligations (or it will need to address the resolution of any pending delinquencies) as well as, in many cases, the payment of a termination fee.

Care should also be taken to tie up any loose ends. For example, there may be common area maintenance payments or adjustments or tax obligations which should survive termination or otherwise be addressed. Also, the parties must consider the survival of the parties' respective obligations to indemnify each other for matters arising during the lease term; while these provisions are typically drafted to survive expiration or termination of the lease, attorneys drafting or negotiating a termination agreement cannot assume that this is the case. Additionally, provisions such as those regarding the required condition of the premises upon surrender, liability for holding over, and similar housekeeping matters may need to be addressed. One simple but elegant solution, after the parties are sure that the specific items that need to be addressed in the context of the termination have been addressed, is to simply provide in the termination agreement that (i) terms of the lease not expressly amended by the agreement remain in full force and effect, and (ii) once the terms and contingencies of that agreement have been met, the expiration date of the lease term will be accelerated to the intended termination date. This method allows the original treatment of any concerns and obligations that are not specifically addressed (surviving indemnity obligations, for example) to continue in place, although taking effect as of an earlier date than originally contemplated.

In all negotiated termination situations, the parties should strive to cooperate and keep their common goal of a win-win (or at least not a lose-lose) resolution in the foreground of their thoughts. Landlords who fail in this regard may face the prospect of a "midnight run" or other sudden closure as a desperate tenant takes matters into its own hands. The tenant that fails to participate in a cooperative manner may face a hardened landlord position. In each case, rather than working together to achieve the best negotiated result under difficult circumstances, parties that fail to take a "common goal" approach will likely be faced with the same store closure and vacancy, with the added burden of litigation, litigation expenses, and lingering uncertainty.

## **VI. Negotiating in Bankruptcy**

The Bankruptcy Code, under Section 365 allows debtors with leased premises the right to reject a lease. Back in 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") changed the amount of time a debtor has to reject a lease from an almost indefinite period to a total of 210 days. The first 120 days are automatically granted, and an additional 90 days may be added for cause. Any additional time requested may only be granted with the consent of the landlord. This has significantly shifted the decision timelines of both the landlord and the debtor. Prior to the change in the Code, retailers were able to get through various selling seasons (i.e., Christmas, Mother's Day, Back to School) and change merchandise to determine if they could restructure. The shortened time period requires retailers to generally begin the process pre-filing.

Within a bankruptcy setting, a debtor has a right to reject a lease. A rejection allows the debtor to unilaterally terminate a lease without the consent of a landlord. The landlord has a right to file its claim for damages which is not the remaining lease liability but rather a statutorily capped "rejection claim." The ultimate payout to landlords is not necessarily the rejection claim but rather a percentage of that claim based on the recovery the debtor achieves on its liquidation. It is common for the payout to landlords and other unsecured creditors to be zero or minimal. The risk of rejection encourages landlords to renegotiate lease terms as the alternate is often a closed and vacant store.

As an example, in the Things Remembered bankruptcy, the company filed bankruptcy with a portfolio of 400 locations and a requirement to only keep 50. As Things Remembered started rejecting leases, landlords' willingness to renegotiate leases increased dramatically. Things Remembered emerged from bankruptcy with over 175 stores to the benefit of the company and landlords.

Unfortunately, many retailers and landlords don't address pressing problems until it's too late. A bankruptcy is expensive and can be very disruptive. As we have now seen, many of the retailers expected to emerge as successful companies have ended in a liquidation. These include but are not limited to Toys "R" Us, Sports Authority

and Payless Shoes. Retailers and landlords would benefit from open communications earlier in a process but would require landlords reducing rents without the need for a bankruptcy as long as retailers could prove their economic stress.

Ultimately, it's in the best interest of both the landlord and tenant to come up with a solution that gives the retailer the best opportunity to succeed outside of a bankruptcy filing.