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**Workshop #25**

***“DID YOU BUY THAT DRINK FROM A LINK?”  
HOW TO DEFINE GROSS SALES FOR RESTAURANTS & RETAILERS IN THE BOPIS ERA***

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**I. OVERVIEW**

With restaurants pivoting to online ordering/delivery and hard-goods retailers refining their “omnichannel” outreach to customers, the traditional definition of “Gross Sales” is looking more and more antiquated. In this workshop, we will start afresh with the definition of Gross Sales by examining the types of transactions that should be included, excluded or deducted. To provide context, we will examine a Gross Sales definition for a restaurant tenant and then for a hard-goods retailer. We will round things out with dialogue over sales reporting and consider other contexts in which Gross Sales comes into play –sales kick-outs, conditional renewals, store closures and pandemic rent relief.

**II. INTRODUCTION**

Retail leases often include a percentage rent provision to provide a retail center owner an opportunity to participate in the economic success of its tenants’ businesses. Percentage rent is based on the gross sales of a tenant at a particular store. If the tenant achieves a certain volume of gross sales in a given period (a “Breakpoint”), then the tenant will pay a percentage of the gross sales that exceed the Breakpoint as additional rent.

The retail industry is undergoing tremendous change due to a host of factors, the most important of which are, for purposes of this discussion, the rise of internet sales and the effect of the COVID-19 pandemic on changing shopping and buying habits. As mobile devices made it easier for consumers to purchase from apps, the traditional nexus between the consumer and the physical store location has begun to break down. The pandemic and its attendant “lock-downs” and self-isolation forced many to resort to “distance” shopping – even for basic needs. Retailers responded with an increasing array of options to allow the consumer to shop but avoid any personal contact with the retail store itself. Thus, connecting a sale to a physical store location has grown more and more challenging.

Traditionally, the description of what was included in Gross Sales was relatively non-controversial – it was the categories of exclusions and deductions that attracted the parties’ attention. Nowadays, the definition of what is included is at least equal in importance to the exclusions and deductions.

While all this is happening, the retail industry has seen a greater focus on economic performance – both from the retailer’s and the shopping center owner’s perspective. This has led to more intense scrutiny of sales figures. Even in non-percentage rent leases, landlords are asking for sales performance data, to be able to evaluate

the relative success of the tenants' businesses, to assist in valuing the shopping center for mortgage or sale purposes, and to identify potential tenant credit issues where sales are falling.

Landlords and tenants alike are being forced to re-analyze the retail lease definition of Gross Sales in order to have it continue to make sense in a new world of Buy Online Pickup In Store ("BOPIS") and omnichannel retailing.

In addition to the determination of percentage rent, the definition of Gross Sales can impact rights and remedies in other provisions of a lease, including termination rights, exclusive provisions and radius clauses. The COVID-19 pandemic resulted in an unprecedented period of "permitted closures", and, as a result, many landlords and tenants are taking a closer look at permitted closure language in lease negotiations, including the impact of such closures on percentage rent payments.

### III. **GROSS SALES – GENERAL CONSIDERATIONS**

A. ***A Broad Definition of Gross Sales.*** For obvious reasons, landlords prefer a very broad and inclusive definition of Gross Sales:

"The term 'Gross Sales' includes all moneys or things of value received or receivable, including lease or rental revenue (without deductions for uncollectibles), by tenant, its sublessees, licensees or concessionaires or others, for merchandise sold or services performed or equipment, merchandise or other inventory items leased or rented or business conducted (including: interest, time-price differential, finance charges and service charges on time-payment sales, credit sales or lay-away sales) in, about or from the Premises ...."

B. ***Exclusions vs. Deductions.*** The tenant's goal during lease negotiations will be to scrutinize the components of Gross Sales – inclusions, exclusions and deductions. Customarily the tenant achieves its goal by negotiating exclusions to and deductions from Gross Sales.

***It is important to correctly categorize a transaction description as an exclusion or a deduction. Exclusions are revenue items that should not even be included in the tenant's Gross Sales. By contrast, deductions are subtracted from the Gross Sales total after having been initially included in Gross Sales due to the nature of the expense.***

C. ***Common Exclusions from Operating Expenses.*** The definition of Gross Sales should be inclusive, but allow for reasonable exclusions. The rationale is that transactions generating proceeds not in the ordinary course of the tenant's business should not be included in Gross Sales. Some common exclusions are:

- Exchanges of merchandise by customers, but only to the extent of the value of the merchandise returned for exchange.
- Deposits from customers, provided the full amount of the deposit is included in Gross Sales when the sale is finalized or the deposit is forfeited by the customer.
- Sales of merchandise to tenant's in-store employees.

*Landlords will often include a provision stating that discounts to employees may be excluded to the extent the discounts do not exceed a certain percentage of the Gross Sales; 1% - 3% being a common range. Additionally, landlords sometimes seek to limit this item to the amount of the discount only, since sales to employees at discount are akin to promotional sales to consumers.*

- Meals sold or given to tenant's in-store employees and complementary meals offered for promotional purposes.

*Landlords may want to limit this exclusion to not more than 1% or 2% of tenant's Gross Sales, in the aggregate for all such meals.*

- Receipts from vending machines installed solely for the use of tenant's employees.

- Tips or gratuities actually paid to tenant's employees and not retained by tenant.

- Bad debts.

*Landlords may want to add that, if the bad debt is later collected, the amount is to be added to Gross Sales for the lease year in which the bad debt is collected.*

- Rent paid to tenant by a subtenant, licensee or concessionaire.

*Landlords may want to add for clarity that, despite the rent exclusion, any sales by a subtenant, licensee or concessionaire at the Premises is to be included in Gross Sales. This can be an important consideration for tenants such as hair or nail salons where the individual technicians are receiving the revenue from the sale as opposed to payments being made directly to the tenant. Landlords should also consider whether any limitations should be placed on the square footage that is not producing traditional sales from any subtenant, licensee or concessionaire and the impact of such uses on the Breakpoint.*

- Delivery and shipping charges to customers paid in connection with a sale.

*Landlords may want to add for clarity "provided Tenant receives no gross profit from the delivery or shipping charges".*

- Alterations or monogramming fees that are paid by tenant to third party service providers.

*Landlords may want to add for clarity "provided Tenant receives no gross profit from the fees".*

- Interest, finance and carrying charges on credit sales transactions.

*(Note: this is not credit card transactions, but credit sales offered by the tenant.) Landlords may want to limit this exclusive to not more than 1% - 2% of Gross Sales per annum.*

- Credit card fees and fees paid by tenant to banks in connection with acceptance of customers' ATM or debit cards.

*In actuality, this category of exclusion is much broader now than before and should now include all merchant fees and fees charged by payment processors or card issuers (including such payment services as PayPal and Apple Pay). Landlords may attempt to limit these fees to a percentage of Gross Sales but these days the processing fees are not within the average retailer's control.*

- Off-premises operations or catering revenues for items prepared and served off-premises, including all deposits for such off-premises catering not refunded to purchasers.

*Landlords will want to carve back into Gross Sales all sums collected from all take-out and delivery business generated from the premises.*

- Sales of promotional items at cost.

*Landlords may question why sales at cost would be excluded while promotional sales would be included in Gross Sales. Should it depend on whether the buyer is a consumer or someone in the trade?*

- Exchanges of merchandise between tenant's stores.

*Landlords may want to add the qualifier that to be excluded the exchange must be made solely for the convenient operation of tenant's business and not for the purpose of consummating a sale made at the premises.*

- Returns of goods or merchandise to shippers or manufacturers.
- Amounts received from claims for loss or damage to merchandise.
- Sales of tenant's furniture, fixtures and equipment.
- Bulk sales not in the ordinary course of business.
- The sale, transfer, or exchange of the entire business of tenant.
- Charitable donations given to tenant which are donated to the charitable organization by tenant in full.

D. ***Deductions from Gross Sales.*** Deductions from gross sales are much less prevalent than exclusions. **It is important to landlords to make clear that the deductions must first be included in Gross Sales in order to be eligible for deduction.** The following are deductions sometimes seen in retail leases:

- The amount of any actual refunds or credits made by tenant to a customer or purchaser for returned merchandise, the sale of which was previously included in Gross Sales.
- the amount of any sales, luxury or excise tax on sales which is both added to the selling price and paid to the taxing authority by tenant.

*Landlords frequently want to make clear that, other than sales tax included in the sales price, taxes imposed on the tenant (e.g., franchise tax, capital stock tax, income tax or tax based upon tenant's income, capital structure, or profits) are not deductible items.*

#### IV. **GROSS SALES – RESTAURANT**

A. ***Definition of Gross Sales.*** From the landlord's perspective, the percentage rent provision should include an expansive definition of gross sales. Example:

Gross Sales shall include (as of the date of the transaction) the aggregate selling price of all goods and merchandise sold, leased, rented or licensed and the charges for all services and all other receipts in, upon or from any part of the Premises, whether (wholly or partially) for cash or credit, and shall include sales from vending machines (including but not limited to mechanical and electronic machines, except telephone and postage stamp machines, but excluding those vending machines maintained for the exclusive use of Tenant's employees); catering orders; delivery orders prepared at the Premises; all deposits not refunded to purchasers; and all monies which Tenant is entitled to receive for items sold at the Premises.

Now, the exclusions and deductions (without real specificity as to which is which):

- The following shall be deducted or excluded, as the case may be, from Gross Sales: (i) refunds, credits or allowances to customers (regardless of where the goods were purchased); (ii) sales, use, excise, or similar taxes imposed in a specific amount, or percentage upon, or determined by, the amount of sales; (iii) sales not in the ordinary course of Tenant's business, of machinery or equipment which Tenant has the right to remove from the Premises; (iv) discounts to employees or complimentary meals served to employees (to the extent same do not exceed 3% of Tenant's Gross Sales); (v) to the extent that the amount thereof was previously included in Gross Sales, bad debts and walk outs" (customers leaving the Premises without paying for goods and services received), not exceeding 3% of Gross Sales per Lease Year (said bad debts shall be included in Gross Sales if received after the same have been deducted from Gross Sales); (vi) insurance proceeds or other sums, credits or refunds received by Tenant from manufacturers in settlement of claims for loss of or damage to merchandise; (vii) delivery charges and tips paid to third party providers

to the extent that such charges are either paid directly by the customer or paid by Tenant to such delivery provider without profit to Tenant; (viii) fees received for classes and demonstrations conducted within the Premises at no profit to Tenant; (ix) any transaction, interest, finance, service or carrying charges charged by any credit card or debit card company, processor or financial institution used by Tenant and to whom Tenant pays such charges and separately stated finance charges collected in any private credit cards issued by Tenant; (x) charitable donations by Tenant of goods or services in an amount equal to the normal sales prices of such goods or services as sold at the Premises, contributed to an unaffiliated "not for profit" organization; (xi) rent income and any license, concession, franchise or royalty fees; (xii) sales of gift certificates, gift cards or like vouchers, provided the same shall be included in Gross Sales if the same is redeemed at the Premises; (xiii) receipts from telephones, vending machines and stamp machines installed in the Premises solely for the use and convenience of Tenant's employees; (xiv) the value of coupons, discounts and promotional offers used, granted or redeemed at the Premises; and (xv) tips or gratuities actually paid to tenant's employees and not retained by tenant.

**B. *Special Issues for Restaurant Gross Sales.***

- **Third Party Apps.** In recent years, the use of third party delivery apps such as Uber Eats, Postmates and Door Dash has dramatically increased. Pricing on these apps may not match the pricing offered by tenant within the restaurant. Additionally, the apps may divert orders to different restaurants without tenant control. The apps also charge fees, some of which are paid to the restaurant, some of which are paid to the app provider, and some of which are split between the app provider and the restaurant. Depending on the restaurant and its structure, these sales may or may not be counted as sales from the restaurant. Should such delivery orders be included in Gross Sales? Should the fees paid by the customer be included in Gross Sales? If so, to what extent?
- **Catering.** Catering sales from the premises can be a point of contention for restaurants. These orders have less of a nexus to the premises as they are being delivered to another location. Should orders fulfilled from the premises be included in Gross Sales? Does the source of origin of the order (i.e. online or taken in person at the store) dictate whether the catering order should be included?

**V. GROSS SALES – HOME FURNISHINGS**

A. ***Definition of Gross Sales.*** For purposes of our discussion today, here is a fully negotiated definition of Gross Sales from a home furnishings store lease:

*First, the "inclusive" text:*

Gross Sales shall include (as of the date of the transaction) the aggregate selling price of all goods and merchandise sold, leased, rented or licensed and the charges for all services and all other receipts in, upon or from any part of the Premises, whether (wholly or partially) for cash or credit, and shall include sales from vending machines (including but not limited to mechanical and electronic machines, except telephone and postage stamp machines, but excluding those vending machines maintained for the exclusive use of Tenant's employees); all deposits not refunded to purchasers; and all monies which Tenant is entitled to receive for items sold at the Premises.

*Now, the exclusions and deductions (without real specificity as to which is which):*

The following shall be deducted or excluded, as the case may be, from Gross Sales: (i) refunds, credits or allowances to customers (regardless of where the goods were purchased); (ii) sales, use, excise, or similar taxes imposed in a specific amount, or percentage upon, or determined by, the amount of sales; (iii) interest, service,

finance or sales carrying charges paid by customers for extension of credit on sales; (iv) returns to shippers and manufacturers; (v) sales not in the ordinary course of Tenant's business, of machinery or equipment which Tenant has the right to remove from the Premises; (vi) the value of any exchange or transfer of merchandise between stores or warehouses of Tenant if it is made solely for the convenient operation of Tenant's business and not for the purpose of consummating a sale made in, at, or from the Premises; (vii) discount sales to Tenant's employees, not to exceed 3% of Gross Sales (Gross Sales in excess of the aforementioned percentage shall be included in Gross Sales in the amount of the discounted price paid by employees); (viii) to the extent that the amount thereof was previously included in Gross Sales, bad debts, not exceeding 3% of Gross Sales per Lease Year (said bad debts shall be included in Gross Sales if received after the same have been deducted from Gross Sales); (ix) insurance proceeds or other sums, credits or refunds received by Tenant from manufacturers in settlement of claims for loss of or damage to merchandise; (x) post, freight, insurance, express and delivery charges collected from customers to the extent not retained by Tenant; (xi) charges for gift wrapping, repairs, alterations and delivery charges; (xii) other similar minor auxiliary services to the extent not usually or customarily considered by Tenant as merchandise sold or services rendered at a profit; (xiii) fees received for classes and demonstrations conducted within the Premises at no profit to Tenant; (xiv) any transaction, interest, finance, service or carrying charges charged by any credit card or debit card company, processor or financial institution used by Tenant and to whom Tenant pays such charges and separately stated finance charges collected in any private credit cards issued by Tenant; (xv) charitable donations by Tenant of goods or services in an amount equal to the normal sales prices of such goods or services as sold at the Premises, contributed to an unaffiliated "not for profit" organization; (xvi) rent income and any license, concession, franchise or royalty fees; (xvii) sales made at the Premises by means of the internet, mail order, catalog orders or telephone orders as long as such sales are not rung through the registers at the Premises; (xviii) the selling price of merchandise delivered from the Premises pursuant to sales made by means of the internet, mail order, catalog or telephone orders or orders placed at other stores, as long as such sales are not rung through the registers at the Premises; (xix) sales of gift certificates, gift cards or like vouchers, provided the same shall be included in Gross Sales if the same is redeemed at the Premises; (xx) receipts from telephones, vending machines and stamp machines installed in the Premises solely for the use and convenience of Tenant's employees; (xxi) installment or "lay-away" sales, provided that on any such sale, any deposit received by Tenant shall be included in Gross Sales only upon the first to occur of (a) completion of such sale or (b) when Tenant is entitled to retain and not return such deposit; and (xxii) the value of coupons, discounts and promotional offers used, granted or redeemed at the Premises.

**B. *Special Issues for Home Furnishings Gross Sales.***

- **Internet/App Sales Excluded.** Landlords ask – Why are sales made at the premises using the internet or telephone orders (or using the merchant's app) excluded so long as such sales are not rung through the registers at the premises? Doesn't the presence of the store lend to the activation of the sale, meaning that the landlord should be entitled to Gross Sales credit for the sale? Is it simply that the retailer does not have the technological tools to attribute an internet sale to a physical store location? Are there not tracking technologies available to capture that sale and attribute it to the store if the customer is physically present there?
- **BOPIS ("Buy Online Pickup In Store").** If the store is merely the location where the customer retrieves the merchandise, then tenants argue that the sale should not count as originating at the store. But landlords don't want their stores to be relegated to "warehouses", with no credit being received for the consummation of the sale transaction (delivery of the product). Is it fair to landlords to have the determining factor be whether or not the sale is rung through the store's registers? Can tenants thereby "game the system"?

Should the following also receive the same treatment (excluded unless rung through the store's registers):

- Curbside pickup or BOPAC: A subset of BOPIS in which customers receive their items outside the store, often without leaving their car.
- BORIS: Buy-online-return-in-store.
- ROPIS: Reserve-online-pickup-in-store. This method allows customers to order an item for in-store pick, but not actually pay for it until they receive it.
- **Buy In Store Deliver to Home.** This one should be non-controversial. Based on the prior discussion, if the purchase is made at the store (and thus presumably rung through the store's registers), then it is included in Gross Sales. The delivery to the customer's home is a mere incidental, not relevant to the treatment of the sale for Gross Sales purposes.
- **Returns.** Refunds, credits or allowances to customers are deducted from a store's Gross Sales (regardless of where the goods were purchased). Tenants argue that the landlord may well benefit from additional sales where the customer has entered the store to make a return; in fact, there is data to support that notion. But the return lowers Gross Sales at a location that likely did not gain the benefit of the initial sale transaction.

## **VI. REPORTING REQUIREMENTS.**

A. **Payment of Percentage Rent.** There are various payment structures used for percentage rent with accompanying considerations. A tenant can pay percentage rent monthly based on 1/12 of the annual Breakpoint, and then reconcile the monthly percentage rent paid at the end of the year. This approach requires additional accounting and reporting time, but has the benefit of providing landlords with monthly payments throughout the year, as well as not requiring a large lump sum from the tenant. Tenants can also pay in one lump sum at the end of the year, which reduces the accounting burden on both parties. Finally, tenants can pay monthly starting in the month when the Breakpoint is reached.

B. **Timing of Reports.** In addition to the timing on payment of percentage rent, landlords will also want to consider when reports of Gross Sales must be provided by tenants. Obviously, tenants will need to submit a report with their payment of percentage rent, but a landlord may also want to obtain monthly reports from tenants to be able to identify any trends in a tenant's sales, whether positive or negative. The lease should also contain penalties for failure to timely submit reports (regardless of whether the percentage rent was paid), and provide an ability for the landlord to estimate sales if the reports have not been submitted.

C. **Contents of Reports.** Tenants will often want to be able to provide reports that are either auto-generated by their point of sales systems or are easy to prepare. These reports however will need to contain enough detail to enable a landlord to determine that any deductions or exclusions have been appropriately accounted for in tenant's calculation of Gross Sales. The lease should require that any categories of deductions or exclusions are separately identified and itemized.

D. **Sales Tax Reports.** Landlords frequently seek to obtain copies of tenant's sales tax reports, either by requiring the tenant to furnish copies upon filing or following the landlord's request or by obtaining the tenant's written authorization to obtain copies of reports directly from the governmental agency. While sales tax figures may serve to corroborate the tenant's own Gross Sales reporting, landlords are advised to note that the Gross Sales definition in the lease will prevail over the tenant's reported sales for sales tax purposes.

E. **Landlord Right to Audit.** Landlords often wish to retain the right to verify the accuracy of tenant's Gross Sales reporting by means of a review or audit of tenant's books and records. In response, tenants seek to place limited on the nature, timing, duration and scope of the audit and impose a confidentiality obligation. A typical audit provision is provided below.

**Landlord Right to Audit.** Landlord shall have the right not more than once during any twelve (12)-month period to cause an audit or investigation of the Gross Sales of Tenant and its subtenants and concessionaires to be made by Landlord or by a certified public accountant selected by Landlord, provided compensation paid therefor is not on a contingency basis for a proper determination of the amount of Gross Sales made in, on, and from the Premises, and all such books, records, and account shall be held available

for such purpose. If any annual statement of Gross Sales previously submitted by Tenant to Landlord shall be found to be incorrect by such audit or investigation in an amount in excess of five percent (5%) of Gross Sales as reported for any Lease Year, Tenant shall immediately pay the reasonable cost of such audit or investigation, as well as any additional Percentage Rent found to be payable by Tenant to Landlord; otherwise, the cost of such audit or investigation shall be paid by Landlord. Any deficiency in Tenant's payment of Percentage Rent as a result of such inaccuracy shall immediately be payable by Tenant to Landlord.

One key consideration for landlords is that the tenant is responsible for the cost of the audit in the event that the statement of Gross Sales is incorrect in order to incentivize tenants to properly and accurately report Gross Sales. Some landlords may attempt to collect interest on any payments that were determined to be deficient as a result of the inaccurate report. In the past, tenants would seek to limit the physical location where a landlord could audit their records to their home office or similar location. Additionally, tenants would seek to limit the number of years of records that were required to be retained. With the advent of internet based recordkeeping, these considerations are becoming less relevant.

F. **Tenant Closures.** A lease will typically permit tenants to close for various periods of time, including for remodeling, restocking, casualty, condemnation, specified holidays or force majeure. While such closures are correctly not considered defaults under the lease, landlords should carefully consider the impact of such closures on a tenant's ability to hit the negotiated Breakpoint as no sales will be generated during these periods. Accordingly, it is important to landlords to set duration limits on the various categories of closures. During any period of closure that is not expressly permitted under the lease, landlords will want to be able to either impute sales or reduce the Breakpoint proportionally for such closure. Imputation of sales can be based on the period prior to the closure or the same month from a prior year. Whether or not a tenant experiences a seasonal spike in sales can be an important factor in determining what months to use to impute sales.

During the COVID-19 pandemic, treatment of closures became vitally important. Imputing sales from the same month in a prior year could in some cases result in a \$0 imputation, or imputation of sales in a severely depressed market. Should a tenant be able to exercise a kick-out if that tenant had been closed during the measuring period for a closure that was "permitted" under its lease? Should the Breakpoint be proportionately reduced during any closure, whether permitted or unpermitted?

## VII. RELATED LEASE ISSUES.

A. **Radius Clauses - Gross Sales Generated from Tenant's Other Stores.** Retail leases often include radius clauses that address a tenant's opening of a similar business within a certain radius of the premises. The inclusion of such a clause in a retail lease is, in part, to protect the landlord's percentage rent income generated by the tenant. If a tenant opens a competing store within close proximity to the premises, customers who normally would have shopped at the premises may shop at the other store instead, reducing the amount of gross sales generated at the premises. However, a landlord can negotiate the inclusion of the gross sales generated at tenant's store(s) that violate the radius restriction in the definition of gross sales in the percentage rent provision of the lease. The lease should also require that a tenant must submit to a landlord the same records for the violation store as required under the lease for the leased premises. A sample radius clause is provided below.

Landlord and Tenant acknowledge that (i) the realization of the benefits of a percentage rent lease is dependent upon Tenant's maximization of Gross Sales, and self-competition is inconsistent with the generation of maximum Gross Sales, (ii) the Base Rent was negotiated giving consideration to the Percentage Rent rate and Breakpoint Amount, and (iii) self-competition by Tenant will deprive Landlord of a bargained for consideration. Accordingly, Tenant agrees that during the Term, Tenant will not directly or indirectly through a subsidiary or affiliated company engage in any business similar to or in competition with that for which the Premises is let within the Radius Restriction set forth in the Business Points, unless such business was in existence on the date of this Lease, and the location, nature and character of the business remains the same. If Tenant breaches the covenant contained in this Paragraph, then in addition the right and remedies provided in this Lease for an Event of Default, Landlord may at Landlord's election (i) enjoin the operation of Tenant's violative store, or (ii) include **[100% or 50% of]** all Gross Sales generated by Tenant's violative store in calculating the Percentage Rent due under this Lease. Tenant agrees to provide to Landlord reports of Tenant's Gross Sales from the violating store as required pursuant to this Lease for the Premises.



B. **Early Termination (Sales Kick-out Clauses).** Many retail leases provide the landlord with the right to terminate the lease if the tenant has failed to generate a certain level of Gross Sales in a particular time period (commonly, a lease year somewhere in the middle of the term). Here, the tenant may be torn between a definition of gross sales for percentage rent purposes (with lots of exclusions and deductions) so that the result is a low figure, and a definition of gross sales for the kick-out clause, which the tenant would want to be high. It may be challenging for the parties to negotiate different Gross Sales definitions for different circumstances. However, it would not be inappropriate to use a definition of Gross Sales without any deductions or exclusions to measure a store's performance for purposes of the kick-out clause.

C. **Operating Covenant.** Whenever a tenant is paying percentage rent, it is important that tenant has an obligation to continuously operate from the premises in order to generate sales. Landlords typically like to see the operating covenant tied to the hours of the shopping center. If a tenant is not required to operate, a landlord has no guarantee of percentage rent, and the Breakpoint can quickly become meaningless. Certain restaurants or service providers may seek to have operating hours that vary from the general operating hours for the shopping center; these hours should be negotiated to reflect the busiest times for such tenants in order to increase Gross Sales.

D. **Exclusive Violations.** In certain leases, a tenant may be granted the exclusive right to operate a specific type of business or sell a certain product in the shopping center or in a limited portion thereof. If landlord violates this restriction, tenant may be granted remedies varying from reduction of rent to ultimate termination of the lease. As a condition to tenant exercising these remedies, a "sales test" may be included. The sales test would require that from the period that the violating tenant opened for business or started selling the violating product or service, the tenant claiming the rent reduction experienced a reduction in sales of a specified percentage as compared to a time prior to the violation. This reduction is typically measured over a 6- or 12-month period. The remedy for a violation can also be conversion to a "percent-in-lieu" structure where a tenant is no longer paying base rent, but only a percentage of sales during the period of the exclusive violation.

E. **Options to Renew.** As part of lease negotiations, landlords may require that tenant's sales reach a certain threshold as a condition to a tenant's right to renew their lease. This can be common for newer tenants or concepts as the landlord may want to ensure the tenant is successful before the tenant is permitted to continue to occupy space in the shopping center. This may be the one area of the lease where a tenant would benefit from a more inclusive definition of Gross Sales!

F. **Defaults.** In the event of a tenant default, landlords will seek to recover the rental stream that would have otherwise been payable had the tenant paid rent for the entire term of the lease. While base rent is typically easy to determine, and taxes or operating expenses can be estimated based on a set annual escalation, percentage rent varies from month to month, presenting a unique issue for estimation of income. The default provisions in a lease should identify a method for estimating Gross Sales following a default by tenant, which can be based upon average sales for a period preceding the default.