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Negotiating Exclusive Use Provisions In Retail Leases

Law360, New York (October 5, 2016, 5:16 PM EDT) -- One of the more frequently discussed provisions in a retail lease is the tenant exclusive. This article explains the fundamentals of a tenant exclusive from the perspective of the tenant and the various considerations to provide a healthy and robust advantage over competitors within the shopping center setting.

A tenant exclusive is essentially an exclusive right afforded to a tenant, typically within a retail lease, although often and appropriately incorporated into a recorded declaration or restrictive covenant, to: (1) be the only operator of a certain type, (2) be the only operator to sell a particular good or provide a particular service or (3) exclude other operators that are direct or indirect competitors, or some combination of all three.



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Larger retail tenants typically have their own form language for exclusives that they have developed over the years and require in their retail leases. Shopping center owners and other large sophisticated landlords have grown accustomed to seeing tenants provide their own exclusive language (indeed in many cases given their importance they are included at the letter of intent stage), but because they restrict a landlord's ability to freely lease space, they are heavily negotiated on the business level and between counsel negotiating the lease.

Based upon my experience representing retail tenants, I have compiled a list of items to assist in the negotiation of a tenant exclusive on behalf of a retail tenant. This list is not meant to be exhaustive but rather a highlight of the issues that I come across on a routine basis.

(1) Is the exclusive clearly defined so in five to 10 years from lease execution there is no misunderstanding of what the parties meant to restrict? This is an obvious practice point that can apply to any provision in the lease but with the tenant exclusive you want to pay particular attention to the enforcement side of these provisions. For example, if your exclusive prohibits other fast-food restaurants, does that include restaurants where customers are able to select ingredients? For example, some may argue successfully that while Chipotle may be able to deliver your food faster than McDonald's it is not a fast-food restaurant but rather a quick-service restaurant. A good approach to avoid future conflict is to describe in sufficient detail what type of user is to be excluded and provide a list of examples. This approach can also be used if the exclusive restricts a certain type of product or service.

(2) In the instance where the exclusive is structured such that only a limited amount of floor area can be used for the display and sale of a particular product, you want to make sure you've provided enough definition so that the scope of the restriction is easily calculated. I've come across restrictions which provide that only 10 percent of the floor area can be used for the sale of a certain product. However, such a basic approach is not acceptable. When structuring an exclusive based upon floor area you want to describe whether its gross floor area, leaseable floor area or retail floor area. Does this starting point in measuring the overall floor area including employee-only areas or storage areas? How do you factor in aisles in front of the shelving where certain products are being sold? Adding some definition can resolve these ambiguities. Many tenant exclusives will use "retail floor area" as the basis for a restriction and define it as such areas devoted to the display and sale of items, and exclude areas that are not accessible by the

general public. They will also state that one-half of the aisle adjacent to the shelving where the item is being displayed is to be included in the portion of the floor area being restricted.

(3) In addition to what types of uses, products or other tenants that you want to exclude, the exclusive will need to have a defined, clear geographic scope. Some tenants will be satisfied with limiting the exclusive to only the shopping center, while others want the exclusive to be more expansive and extend it to property beyond the shopping center by way of a radius restriction or by restricting property adjacent to or at the same intersection as the shopping center. Because the landlord may own adjacent properties through affiliated entities you will want to make sure your geographic restriction applies to the affiliated entities and any property that may be acquired by landlord or landlord's affiliates in the future. Additionally, because landlords use different vehicles to obtain a controlling interest in land, it is a good idea to include acquisition by easement, ground lease or by acquiring a controlling interest in a joint venture. To the extent the landlord or the landlord's affiliates currently owns property that would be restricted, a restrictive covenant should be recorded against that property upon lease execution. If and when the landlord acquires land in the future, you want to include an obligation to record a restrictive covenant at the time of acquisition.

(4) Another consideration when negotiating an exclusive is whether and to what extent the exclusive applies to existing tenants. Many landlords take the approach that the exclusive shouldn't apply to existing tenants because those tenants have priority and are operating under a previously negotiated arrangement. To bolster this position, landlords will routinely concede that it cannot require your client to be subject to the exclusives of future tenants without consent. This is a valid point; however, you want the landlord to agree that it will not agree extend or amend existing leases without incorporating your client's exclusive. Similarly, to the extent the landlord has consent rights over an assignment or sublease of an existing tenant lease, you want the landlord to agree that it will not consent to an assignment or sublease without incorporating your client's exclusive. Finally, it would be prudent to review the use clauses contained in the existing tenant leases as some may be already limited to a particular use that will be unaffected by imposition of the exclusive and therefore should apply.

(5) To achieve maximum adherence to the exclusive, it is prudent to include in your lease a requirement that landlord insert in any future leases or amendments your exclusive language rather than relying on (a) the landlord's property manager to notify new tenants of existing restrictions or (b) for the new tenant to review the recorded memorandum of lease or other declaration or restrictive covenant containing the exclusive. Because this an affirmative obligation under the lease, the landlord will place an increased importance on your client's exclusive.

(6) Consider whether the exclusive should include a provision that the restricted land cannot be leased or used for parking, access, signage, utilities or other operational services or facilities that serve a use prohibited by the exclusive. For example, if the exclusive states that the property next door cannot be used as a vitamin store, would there be an objection if landlord allowed it to be used for a parking lot exclusively serving a vitamin store located on property inches outside of the exclusive area? This specific issue has been litigated within the past couple of years with differing results.

(7) When negotiating the duration of the exclusive with the landlord, you want to insist upon the exclusive being in effect during the entire term of the lease. Landlords may resist this approach and argue that the exclusive should terminate upon a tenant default, which I would reject. First, there could be a technical default of which the tenant is unaware. Second, there could be a dispute whether a default actually exists. Third, given that losing an exclusive can have a lengthy impact on the tenant's business operations beyond the lifespan of the default, this is an extreme penalty. If the landlord views a default with particular severity it can terminate the lease and with the termination of the lease the exclusive will terminate.

(8) If there is a violation of the tenant exclusive, you want to require the landlord to enforce the exclusive on the tenant's behalf. Indeed, landlords are in the best position to enforce the exclusive since they have a direct contractual relationship with the offending party — which in most cases is another tenant in the shopping center. If the landlord is the party that violated the exclusive by allowing a tenant to violate the exclusive or by failing to insert the exclusive in a future lease (assuming it has that obligation) you want a set firm penalty such as a rent reduction to be

imposed after a reasonable notice and cure period. Without a rent penalty, landlord's incentive to remedy the default is reduced. Some landlords argue that a tenant can always terminate the lease as a result of a landlord default which provides a sufficient hammer beyond injunctive relief; however, such a tool is inadequate if as a tenant you've spent millions of dollars in ground up development and as a result of terminating the lease the ownership of the building transfers to landlord.

Other issues surrounding tenant exclusives such as dealing with rogue tenants, the cessation of an exclusive during periods that tenant has gone dark and the actual enforcement of the exclusives will be discussed in a later article.

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