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EXCLUSIVE COVENANTS AND RADIUS CLAUSES

Exclusive Use Clauses

- A. Exclusives are Increasingly Common.
1. Landlords: Landlords are facing increased vacancies and renegotiated leases; the leverage and power of tenants has increased as a result.
 2. Tenants:
 - a. Tenants are seeking broader and stricter exclusive protection as they are forced to compete more aggressively for consumers.
 - b. Many individual retailers have expanded their product lines and services, which has caused problems with respect to exclusives.
- B. Problems for Landlord: Big Box Retailers vs. General Classes of Merchandise.
1. Exclusives may be justified in the case of specific "Big Box" retailers, i.e., Home Depot or Barnes & Noble, but only for the primary use of such retailers.
 2. Exclusives are much more problematic when granted in connection with general and closely related classes of merchandise such as apparel, electronics and entertainment categories.
 3. If an exclusive has been granted to a specific tenant for a general class of merchandise, this will dramatically enhance the tenant's power vis-a-vis the Landlord and greatly restrict the Landlord's ability to enter into leases with other prospective tenants.
- C. Problems for Prospective Tenants.
1. Prospective tenants may be prevented from leasing space in a Shopping Center where broad exclusives have been granted to existing tenants.
 2. If the exclusive is too broadly drafted (covering both "primary" and collateral lines of merchandise), it may result in the exclusion of the prospective tenant whose principal business is that of the collateral merchandise of the existing exclusive holder
- D. Drafting a Proper Exclusive Use Clause.
1. Landlord's Perspective:
 - a. A well-drafted exclusive will give the exclusive holder substantially all of the protection it needs while allowing the Landlord sufficient flexibility to lease to other acceptable tenants whose normal merchandise lines may include some of

the goods of the exclusive holder.

- b. A poorly-drafted exclusive may (A) subject the Landlord to the approval of the exclusive holder every time the Landlord wants to sign a lease with a prospective tenant who may carry some of the exclusive holder's goods, and (B) in the case of an assignment or sublease by an existing tenant, subject an assignee/subtenant to the consent of the exclusive holder if the proposed assignee/subtenant carries (or may in the future carry) some of the exclusive holder's protected merchandise.

2. Tenant's Perspective:

- a. Should contain a covenant that Landlord will not do anything to impair or limit the tenant's ability to conduct the permitted use.
- b. In those circumstances where Landlords are unwilling to provide existing exclusives to prospective tenants, as an alternative such Landlords may offer to indemnify the incoming tenant.
- c. As a practical matter, a prospective tenant should insist on receiving the text of the actual exclusive clauses before it signs a lease. Specifically, the text of the exclusives should include the exclusive holder's remedies for a violation of the exclusive (i.e., whether the existing exclusive holder may pursue all its legal remedies to prevent the incoming tenant from entering the center, or simply receive other concessions in the form of minimum rent reductions, conversions to straight percentage rent or the ultimate right to terminate). This additional information will often determine who takes the risk of violation, i.e., whether the Landlord is to seek a waiver for the benefit of the incoming tenant or for itself.
- d. Under common law principles, existing leases are not subject to exclusives entered into subsequent to the tenant's lease. From a tenant's perspective, it should seek to incorporate the following lease provisions: (A) that the lease expressly reaffirm the principle that as a pre-existing lease, it will not be subject to any future exclusives so long as the present tenant's lease is in effect, including renewals and regardless of who is in actual occupancy of the premises under that lease, (B) that the Landlord be required to disclose to prospective tenants the existing tenant's use clause rights and its immunity under item (A) above, and (C) to record a memorandum of lease containing as much information as is reasonably necessary to impart notice of (A) and (B) above.

F. Elements of a Well-drafted Exclusive Clause.

1. Must only protect the principal/primary use of the exclusive holder and must be specifically defined.
 - a. Right to conduct a particular *business*

b. Right to sell specific *products*

c. If possible the exclusive should be drafted so that the exclusive holder must carry the protected merchandise in excess of a certain percentage of its total floor area or sales; if it falls below the prescribed levels, the exclusive would become null and void.

d. May also want to tailor the exclusive based on "category" considerations.

e. Depending on the size and configuration of the Shopping Center, it may make sense to tailor the exclusive so that it applies to only a certain designated portion of the Shopping Center.

2. The other tenant's merchandise must directly compete with the exclusive holder's merchandise.

3. The protected merchandise must allow an encroachment or overlap to an "incidental" extent.

4. Existing leases and their renewals should be exempt so long as their use clauses are not expanded or enlarged to encroach upon the exclusive holder's merchandise.

5. Exclusive holders would prefer a menu of remedies if an exclusive is violated.

6. If the violation of the exclusive has not been cured and the exclusive holder is paying reduced rent, the Landlord may require the exclusive holder to resume payment of full rent after a specified period of time.

7. Stores of a certain size, present or future, should be exempt.

8. The sale of any "unauthorized tenant merchandise" should not trigger a violation of the exclusive until the Landlord has failed to cure the violation after a reasonable period of time.

9. Any tenant permitted to assume a lease or operate a business as a result of bankruptcy, insolvency or as the result of an action or order by a court should be exempt.

10. The exclusive should remain personal to the original tenant, but may also pass to assignees or subtenants in a transfer where Landlord's consent is not required.

11. The exclusive becomes null and void if the exclusive holder is in default beyond the applicable notice and grace periods.

12. The exclusive becomes null and void if the exclusive holder is not

engaged in the protected use or sale of the protected merchandise for a period of time or is not open for business.

Radius Restrictions

1. Radius restrictions are limitations on a particular tenant's ability to open a competing store within a certain area around tenant's current location.
2. Such clauses must be "reasonable" to withstand antitrust scrutiny.
3. Radius restrictions are put into leases so that:
 - a. Landlords can depend on the tenant to maintain a certain level of gross sales for percentage rent purposes; and
 - b. Customers are not drawn away from the tenant's store and the center as a whole to the competing center with the same store.
4. Tenants argue against these clauses because:
 - a. Tenants need to meet their competition and not be prevented from competing;
 - b. If there is a market for an additional store near the original store, Tenant would not open such store at the cost of the original store - it would not make sense economically; and
 - c. Customers would not be drawn away from the center just because tenant opened another store nearby (most tenants do not have that kind of power); rather customers would be driven away because there is a new center.

A radius violation occurs when a "tenant" during a "radius period" within a "restricted area" opens a "competing store".

1. "Tenant" is defined as tenant and its affiliates (or expanded to any controlling interests in tenant).
2. "Radius Period"
 - a. Typically, a compromise based on the length of the term (i.e., 3 years or 7 years) or the end of a kickout period, if applicable, is the typical middle ground.
3. "Restricted area"; limiting the area for which the restriction applies:
 - a. Landlord would like the area to be as large as possible but depends on location (i.e., city v. suburban v. rural).
4. "Competing store" is:

a. Landlords like to define "competing store" as broadly as possible. Tenants should be careful to allow a broader definition than necessary or applicable.

b. "Competing store" should:

(i) operate under an identical name

(ii) carry identical merchandise to the protected merchandise

(iii) carry such merchandise primarily and at the same time as the tenant; and

(iv) be of a similar size to tenant.

C. Typical Exclusions.

1. Existing stores;

2. Changes in trade names;

3. Relocation of existing stores into the radius area;

4. Opening of a location in centers different from the center in which the tenant is located (e.g., strip v. mall); and

5. Other divisions of a tenant or operations under a different name (or specifically named stores).

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