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# Surviving the Retail Shift

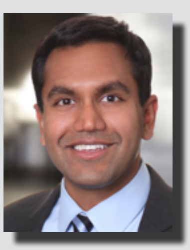
## *Part 3 of a 5 Part Series:*

## Coping with Retail Closures and the Evolution of the Shopping Center: Balancing Creative Uses with Co-Tenancy Provisions

**Authors**:

**Kelly D. Stohs**
913.234.7525
kstohs@polsinelli.com

**David P. Vallas**
312.873.3620
dvallas@polsinelli.com



**Sohil M. Shah**
312.463.6319
sshah@polsinelli.com

*By Kelly D. Stohs, David P. Vallas, and Sohil M. Shah*

Shopping centers are not dying. The retail landscape is changing, however, and so too are shopping centers. Retail stores have been closing at a breakneck pace, and Wall Street seems to think the worst is yet to come. Investors are more negative on the retail industry than any time since September 2008, according to statistics from Bespoke Investment Group on the average percentage of shares of retailers being shorted.

The volume of store closings is challenging shopping center owners to evolve. Shopping centers are becoming more about experiences than shopping. Shopping center owners have responded by finding creative uses for vacant spaces and ways to enhance the customer experience. Some shopping centers have split former anchor space into as many as 20 smaller stores. Others have converted anchor spaces into hot spots for attractions and community events. Some big box vacancies have been converted into movie theaters, concert or entertainment venues, museums, classrooms, fitness gyms, grocery stores, or even residential apartments or office spaces.

Shopping centers owners should beware, however, that creative uses may implicate co-tenancy provisions in the leases of their other tenants. Co-tenancy provisions generally give a tenant certain rights in the event that the occupancy of the shopping center falls below a certain threshold, or in the event certain named anchor or a major tenant closes its doors and is not replaced by a similar tenant. The violation of a co-tenancy provision typically allows a tenant to pay reduced rent or perhaps to terminate the lease altogether. These disputes often involve interpreting common terms under unique circumstances.

## Is the Replacement Anchor Tenant a "Similar Tenant" For Purposes of a Co-Tenancy Provision?

A California case this past year addressed what constitutes a "similar" replacement tenant under the terms of a co-tenancy provision after a shopping center owner found a creative use to fill an empty space. See *RadioShack Corp. v. Azusa Pacific Univ.*, 2016 WL 3640370, B262107 (Ct. App. Cal. June 30, 2016). RadioShack's lease allowed Radio Shack to terminate its lease or pay reduced rent if a major tenant in the shopping center closed its doors and was not replaced with a "similar tenant." The lease defined "similar tenant" as a tenant occupying all of the same leasable area that was occupied by the vacated major tenant, selling "the same or higher quality of goods" and having equal or better foot traffic. When the shopping center replaced discounter Big Lots, which sold a wide variety of merchandise, including packaged food and beverages, toys, furniture, clothing, housewares, and small electronics, with a fitness center selling ancillary items such as water, snacks, and t-shirts, RadioShack complained a fitness center was not a "similar tenant" because it sold goods of a lessor quality. The court disagreed, explaining that the lease did not limit "similar tenant" to only a "retail tenant."

The results have not been so positive for shopping center owners in other cases. In *Shoe Show, Inc. v. One-Gateway Assocs., LLC*, No. 1:10CV13, 2015 WL 5674876, at *8 (M.D.N.C. Sept. 25, 2015), the court affirmed reduced rent for retailer Shoe Show because of a co-tenancy violation. The co-tenancy provision in that case called for reduced rent in the event women's apparel retailer Cato closed and was not replaced "by another similar major tenant occupying at least ninety percent (90%) of the leased premises." Cato closed its doors and Daystar Bible Book Store filled the 3,680 square feet of retail space. Shoe Show argued that a "similar major tenant" must be a national or regional ladies' fashion apparel retailer, while the shopping center interpreted "similar major tenant" to mean a retailer with a significant market presence to drive customers to the shopping center. The court explained that "similar" means something less than identical, but the lease provided no guidance about how "similar" a replacement tenant must be to avoid triggering the co-tenancy provision. The shopping center owner further argued that it satisfied the co-tenancy requirement because it leased 20,000 square feet of space in the center to clothing store Goody's five years earlier, but after Shoe Show had opened its doors. The court rejected this argument because the co-tenancy provision required that Cato be "replace[d]" by a similar tenant, and Goody's did not occupy any portion of Cato's former premises.

Similarly, in *Old Navy, LLC v. Center Developments Oregon, LLC,* No. 3:11-472, 2012 WL 2192284 (D. Or. 2012), the court granted summary judgment for retailer tenant Old Navy when the shopping center owner replaced "key store" tenant GI Store – a retail sporting goods, clothing, and auto parts chain – with a grocery store in violation of a co-tenant provision.

## How is Occupancy Percentage Calculated Under a Co-Tenancy Provision?

Co-tenancy disputes may also arise over how the percentage of occupancy is calculated, particularly when the terms of a co-tenancy provision is ambiguous. The lease in *Best Buy Stores, L.P. v. Manteca Lifestyle Center, LLC,* 859 F.Supp.2d 1138 (E.D. Cal. 2012), provided that Best Buy must only pay the full monthly rent if, "sixty percent (60%) (not including Best Buy) of the gross leasable area of the Shopping Center are [sic] open and operating at the Shopping Center . . . ." The parties disputed the meaning of "gross leasable area of the Shopping Center" and whether it should be defined by the site plan or other portions of the lease, which suggested that a building must be fully constructed to be added to the GLA. Denying Best Buy's motion for summary judgment, the court concluded that the 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.

In *Claire's Boutiques, Inc. v. Brownsburg Station Partners LLC,* 997 N.E.2d 1093 (Ind. App. 2013), the co-tenancy provision allowed Claire's to terminate its lease if the occupancy level fell below "70% on the non-department retail store tenants" for one year. The court rejected the shopping center owner's argument that occupancy should be calculated based on the percentage of GLA leased because the co-tenancy provision specifically defined the occupancy level as the percentage of tenants. The co-tenancy provision also contained the clause, "notwithstanding anything to the contrary contained in this lease," which precluded any consideration of leased provisions that appeared to be in conflict. Thus, the court held that the Claire's properly terminated its lease under the co-tenancy provision when the number of tenants occupying the shopping center fell below seventy percent.

## Conclusion

These cases are stark reminders that shopping center owners should be mindful of co-tenancy provisions when filling dark spaces with creative uses. Likewise, drafters of retail leases should carefully draft co-tenancy provisions with foresight that shopping centers will continue to evolve. They should consider whether co-tenancy should be tied to specific named retailer, to a specific type of retailer like women's apparel, or simply to a retailer that has a proven track record of driving foot traffic. They should strive to define common lease terms like "similar tenant" to avoid any doubt about how similar a "similar" retailer must be, and they should be clear about whether occupancy is based off of GLA or the number of tenants, regardless of size. There is no doubt that the retail landscape has shifted and will continue to shift. As shopping centers evolve, owners must be aware of the impact of co-tenancy provisions and avoid the rigidity of loosely drafted language.

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