

Leasing headache No.1: inclusion of exclusions



Kilberg



Rothschild

Lori Kilberg and Benno Rothschild are attorneys at Hartman Simons & Wood, a 30-attorney law firm based in Atlanta that specializes in commercial real estate acquisitions, sales, financing and leasing. Kilberg and Rothschild lead a team dedicated to representing outlet owners and developers throughout the country.

Outlet attorneys Kilberg and Rothschild offer tenants and landlords a solid explanation of exclusives, plus tips on keeping them workable.

EXCLUSIVE COVENANTS have been part of the retail leasing landscape for many years. They represent an important facet of the push-and-pull relationship between landlords and tenants: Tenants want to maximize sales by restricting or prohibiting other tenants in a shopping center from selling the same or similar products, and landlords need merchandising flexibility to achieve maximum returns.

In traditional shopping centers, the landlord is focused on drawing shoppers with a wide variety of tenants, from sporting goods and book stores to grocers and pharmacies. Tenants in these centers often seek exclusive restrictions so that they are the sole provider of any one use (other than general apparel). Landlords may agree to some of these exclusives to attract particular tenants and product types.

The health of a great outlet center depends on the critical synergy of many competing retailers that also count on the tenants surrounding them to increase their own sales. As a result, landlords successfully argue that overlapping uses don't weaken well-run stores. Instead, neighborhoods of similar tenants actually draw a larger audience.

The lure of increased choices and value pricing is what drives shoppers to outlet centers. In strong, high-volume outlet centers, landlords can resist granting any exclusives at all. In these exclusiveless centers, tenants depend on high foot traffic to blunt the potential pressure on sales from having direct competitors nearby. However, in new outlet centers that lack a track record or in older outlet centers that are missing the allure of being near a large population, retailers used to having exclusives in the full-price world pressure outlet landlords to some form of an exclusive.

Sometimes retailers want category exclusives to limit the type of merchandise other tenants can sell. More unique to outlet centers, though, are brand exclusives, which focus on labels rather than merchandise categories. Whereas "use exclusives" restrict a merchandise category, such as kitchenware, furniture or (more problematically) clothing types, or categories such as athletic wear or shoes, "brand exclusives" restrict specified brands. Many outlet leases contain an outright prohibition restricting the sale of other manufacturers' branded products.

While brand exclusives have been common to outlets in the past, the changing nature of outlet centers has caused this type of restriction to be challenged. The proliferation of licensing among major fashion labels

has created conflicts between licensees that translate into even bigger headaches for landlords. What happens to Tenant B when Tenant A has a national license to sell items manufactured and branded by another retailer in the center? Does the license trump the lease restriction? The answer is most likely, NO.

A diligent landlord will try to get a waiver from Tenant B before it leases to Tenant A. Even though someone in corporate headquarters sold a license to Tenant A, direct competition in the outlet world probably wasn't anticipated, so Tenant B now has leverage to keep that competition out of this particular outlet center, or pressure the landlord for other concessions.

If granting an exclusive is required to make the deal work, the parties should carefully consider what can happen if it's violated. And be aware that the courts give strict scrutiny to any contract that limits competition, so an attempt to make a restriction too broad can be voided. Far too often we see landlords forced to seek waivers (and make concessions) due to exclusives that almost certainly were never intended to cover the use in question. In general:

DO:

- ✓ Insist that the tenant with the exclusive be open and operating for its permitted use without any default
- ✓ Carefully define the exclusive product or product type and allow other tenants leeway for "incidental sales" of such products
- ✓ Carve out anchor tenants, existing tenants, and specify that their successors or assigns are not affected by an exclusive – even if they relocate or sign a new lease rather than simply renewing their lease.

DON'T:

- ✓ Allow a remedy that might permit a tenant to pay no rent or virtually no rent, but still operate for business – especially if they don't have to prove they are hurt by a competitor violating their exclusive
- ✓ Give a remedy without some kind of "sunset clause" requiring a tenant to either go back to its normal rent or terminate its lease if an exclusive violation is not remedied within a specific time period (typically one to two years).
- ✓ Allow an exclusive to affect future phases of a multi-phase development.

Given the unique nature of outlet centers as a tourist and destination venue where customers spend long periods of shopping time, the more competition there is, the higher the level of traffic and sales. "Exclusiveless" centers place all tenants in an equal position and help remove conflicts between the retailers and landlords. However, if exclusives have already been granted, or if the retailer's requirements prevail, the exclusives must be carefully drafted to be as specific and limited as possible to allow the center to grow and thrive. ■