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Retail Leases

Consuella Simmons Taylor

Author Contact Information:
Consuella Simmons Taylor
Baker Botts L.L.P.
Houston, TX 77002

connie.simmons.taylor@bakerbotts.com
713.229.1234

I. INTRODUCTION

Leases for space that will be utilized for retail purposes present unique challenges not found in other types of leasing. This paper will offer practical tips for drafting certain specific types of provisions for retail leases and will outline the preferred outcome based on whether you represent the landlord or the tenant. Several sample provisions are also included as appendices to this paper for reference.

Retail leasing is different than office leasing in many respects. A retail tenant is much more concerned with its location, both within a market area and within the larger development (whether mall, shopping center or mixed-use project). Retail tenants are also much more concerned with the common areas near their location and their rights to signage in and around the larger development. Parking will also be a concern, as will the uses of the other tenants within the development.

II. USE CLAUSE

One of the first things that must be a 'fit' for both the landlord and the tenant in connection with a retail lease is the use for which the tenant will operate the premises. A typical landlord is looking for a certain tenant mix within its development and seeks out uses the landlord believes will be complementary so that each individual tenant (and the development by extension) will be profitable. For this reason, a landlord will want to precisely define the use a tenant can engage in at the premises and limit any right to change the use during the lease term. A landlord-friendly use clause will be narrowly drafted and contain language prohibiting the premises to be used for any purpose other than the stated use. A tenant, on the other hand, will want flexibility in the use clause. If a tenant determines that a certain use will not work in a certain location, the tenant would like the ability to change the use prior to exiting the location. In fact, the most tenant-friendly use clause will simply require the tenant to operate for a lawful retail use. If the tenant has a great deal of leverage, it might be able to command such a broad provision. If a tenant is not able to negotiate such a broad provision in the first instance, an alternative is to negotiate a right to change the initial use at some point during the term. With such a clause, a tenant would prefer to limit or eliminate any landlord consent rights. If a tenant includes other concepts within its brand or the brand of its parent company, the tenant may request the right to change to another of its concepts upon delivery of written notice to the landlord, but with no landlord consent rights with respect to the change. If the landlord is comfortable with having any of the tenant's concepts in its development, this may be acceptable. In most cases, however, a landlord will want the right to consent to any proposed new use. Further, the landlord should be careful to protect the uses of its other tenants and limit any right to change use so that a tenant cannot duplicate an existing use or violate an exclusive use clause within the development. Drafting exclusive use clauses will be discussed in the next section of this paper.

The landlord will also want to define a required operating standard for the operations to be conducted from the premises. If the landlord operates a "first-class" development, that landlord will want its tenants to also operate "first-class" retail establishments so that one tenant does not diminish the value of the entire development with a poorly-run store. Such a phenomenon could not only affect the value, but could also result in diminished foot traffic which could have a detrimental effect on the other tenants in the development. Another way to address an operating standard is to use the standard of other existing stores operated by the tenant (if such stores have acceptable operations). This approach may be more palatable to the tenant since the tenant should be comfortable with its own operational standards. If the landlord agrees to use this approach, the landlord may want to tie the standard to a specific location for a tenant if the landlord is comfortable with operations at that certain location. And, in any event, the landlord should define the standard as the tenant's operations as of the date of the lease. This way, if the tenant's operational standards diminish over time, the landlord does not have to worry about the tenant having the ability to reduce its operational standards at the landlord's development.

One last point on use clauses relates to prohibited uses. As a form of protection for the entire development, most landlords have standard lists of uses that are expressly prohibited. This list will apply to all tenants of the development. Tenants will also want the list to apply to the landlord and landlords may agree, although the landlord may want to carve out certain uses based on its future development plans, such as a hotel, movie theater or fitness center. It has become increasingly apparent, however, that many of these standard lists have become somewhat outdated which can be problematic for the landlord. I highly encourage all attorneys who represent landlords to have your client 'dust off' their list of prohibited uses to determine if it needs to be refreshed and modernized. It benefits

all tenants of a development to have a list of certain noxious uses that are prohibited within the development, which may include industrial and warehousing uses, uses of hazardous materials and illegal uses. Some other prohibited uses may include movie theaters, bars, nightclubs and gyms due to their potential impact on parking at a development. Other uses like religious uses, spas and medical uses have been traditionally prohibited, but as the retail landscape keeps changing, these uses are often ways that landlords can backfill vacancies in their developments. In today's leasing environment, it is important for both landlords and tenants to be mindful of the uses that will actually be detrimental to the development and to negotiate a list that meets the objectives of both parties.

III. EXCLUSIVE USE CLAUSE

Since a retail tenant spends so much time deciding on a location, many retail tenants will negotiate the right to have the exclusive right to operate for a certain use within all or a portion of the landlord's development. Many landlords are willing to grant exclusive use rights to attract a tenant to their development and since a landlord is typically concerned with the tenant mix of its development, agreeing that a particular use is limited to one tenant may not be a hardship. If two tenants engage in the same specific use within a development, the likelihood is that the tenants will not be as profitable as they each could be absent the other. And it is certainly in the interest of both the landlord and the tenant for the tenant to be as profitable as possible in a location.

In Texas (as in the United States generally), there was some early question regarding the enforceability of exclusive use clauses from an anti-trust perspective. See *Schnitzer v. Southwest Shoe Corporation*, 364 S.W.2d 373 (Tex.1963). However, it is now generally established that such clauses are enforceable so long as the restriction is reasonable. See *City Products Corporation v. Berman*, 610 S.W.2d 446 (Tex. 1980). In representing landlords, it is important to make sure that any exclusive use clause is not overly broad. A landlord should also review its existing leases prior to granting any 'new' exclusive, as management office personnel can change over time and exclusives could have been granted, but not added to any master list of exclusives.

The interaction between the exclusive clause and the permitted use clause can be interesting. It is becoming more common to see tenants try to expand their use clauses as noted in the preceding section, and as a landlord attorney, clauses should be drafted so that an exclusive clause does not 'mirror' a broad use clause. In today's market, even tenants with a predominant use are requesting numerous ancillary uses. For example, a lease with Barnes & Noble may state that a bookstore is the primary use, but such tenant may have the right to have a café/coffee shop as an ancillary use. Similarly, a Starbucks lease may state that the primary use is the sale of coffee and coffee products, but the sale of sandwiches, pastries, music and books may be ancillary uses. In most cases, the 'ancillary' uses will overlap with another tenant's primary use (and often its exclusive use rights) and landlords should not allow a tenant's ancillary uses to be a part of their exclusive use clause. From a tenant perspective, the use that requires protection is the primary use, and, as long as the ancillary uses are permitted, the tenant should not require the same level of protection for an ancillary use. Furthermore, if a tenant changes its use, its exclusive use rights for the 'old' use should no longer be effective. When representing a landlord, it is common to condition the continued effectiveness of exclusive use clauses on the tenant operating its premises for the protected use – if a tenant is now operating as a bookstore, the tenant has no need for the benefit of a clause giving it the exclusive right to operate an electronics store. Even though the exclusive is a valuable right to the tenant, not many tenants will argue this point, if they have affirmatively changed the use in accordance with the lease.

There is also an interesting dynamic between the exclusive clause and the tenant's operating covenant. Operating covenants will be discussed in more detail later in this paper. From a landlord's perspective, if a tenant is no longer operating within the premises at all, the tenant should not have the benefit of its exclusive use clause. A tenant's attorney will argue, however, that the tenant has bargained for this important right and a cessation in operations (which may be only temporary) should not serve to negate the right. The exclusive clause will also be important to the tenant if it is trying to sublet its space to a retailer operating a similar business as the tenant previously operated from the premises. It may behoove a tenant to negotiate some waiting period after cessation of operations prior to the exclusive being forfeited. A tenant should also try to negotiate the right to assign the exclusive. Many landlords will want the exclusive rights to benefit only the initial named tenant. There is a lot of room for negotiation of the intricacies of these clauses and I have provided a few samples in Appendix A.

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