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Practice Area: Retail Real Estate

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A quick glance at any given newspaper tells much of the story: one big box retailer after the other filing for bankruptcy and going dark. Survey the retail real estate landscape and you'll find a host of dark big boxes tattooed with "Space Available" signs. Needless to say, the "co-tenancy clause" is of much heightened importance in the current retail real estate environment.

The co-tenancy clause – a provision in a retail lease allowing the Tenant to reduce its rent or exercise other remedies if an anchor tenant or specified percentage of other tenants leave a mall or development – is the subject of much negotiation (and consternation) between Landlord and Tenant. While the co-tenancy issue is of great relevance to both Landlords and Tenants, this *Update* touches on five key issues for Tenants in the co-tenancy debate. Landlords – you'll get your turn down the road.

1. Take advantage of co-tenancy protection at as many stages in the retail lease process as possible. Provide for co-tenancy in the letter of intent – no obligation to proceed with leasing unless co-tenancy thresholds are met. Make appropriate co-tenancy a condition to the opening of your store for business. Finally, negotiate a clear, ongoing operating co-tenancy obligation in your lease.
2. Tie your co-tenancy both to the loss of one or more specific anchor tenants and to a requirement that a specified minimum percentage of the shopping center be open and operating. The loss of a big box anchor will hurt...but so will significant vacancies in mid-size and smaller spaces. Be sure to address the meaning of "open and operating" – often a subject of interpretation when a Tenant asserts a violation of the co-tenancy clause.
3. To the extent Landlord requires a cure period or the opportunity to replace a lost anchor tenant with a "comparable" Tenant under a co-tenancy clause, be very specific about the identity, products or services offered, national presence/footprint, national name recognition and/or financial size of the replacement anchor tenant. Tenant's idea of a "comparable" replacement anchor tenant is often very different from that of the Landlord. Also, address whether Landlord has the right to carve up a big-box space and replace an anchor tenant with several smaller tenants. This often results in less drawing power and lower shopper traffic than existed with the original single anchor tenant.
4. Provide for as many Tenant remedies as possible for Landlord's breach of a co-tenancy provision: reduction or abatement of base rent; reduction or abatement of percentage rent; reduced obligation to pay shared operating expenses; right to delay store opening; and/or termination of the lease.
5. Limit Landlord's ability to block or impede Tenant's rights under the co-tenancy clause. Where there is a co-tenancy default, Landlord will often seek a limit on the duration of the period of reduced rent, after which the rent will return to pre-breach levels or Landlord will have the right to re-capture the space. Also, Landlord may seek to require evidence of harm to Tenant (e.g., material reduction in Tenant sales or revenue) before it is allowed to exercise its remedies. Push back – these should be resisted if at all possible.

The foregoing is truly a "wish list" for Tenants seeking co-tenancy protection in their retail leases. Only a highly coveted Tenant with substantial leverage will be able to obtain all or any of the above protections from Landlord. However, it is certainly worthwhile for any Tenant to seek these protections. Particularly in a down retail real estate market, it doesn't hurt to ask.

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