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LEASE LEVERAGE

GAINING THE UPPER HAND

Retail landlords scrambled to retain struggling tenants during the Great Recession, often agreeing to rent concessions to keep properties occupied.

As Retail Market Rebounds, So Do Legal Disputes

BY STEVE ADAMS | BANKER & TRADESMAN STAFF

Mega-bankruptcy cases like Circuit City, Borders and Blockbuster that shuttered thousands of store have played themselves out, with commercial landlords moving on to the next generation of tenants.

While the local retail landscape has recovered in recent years, legal disputes between landlords and tenants remain a common occurrence in all real estate cycles. It all comes back to leverage: the side with the upper hand in negotiations typically can write lease language to their advantage, which plays out in court if the relationship goes sour. A handful of words can decide whether a landlord can collect in big-ticket rent disputes.

“Sometimes there’s more (dispute) activity in an up market than a down market, oddly enough,” said Vincent Pisegna, an attorney at Krokidas & Bluestein LLP in Boston.

A Demand For Exclusivity

Retailers have been rethinking their store footprint sizes in response to the online shopping migration, with chains including Best Buy and Staples rolling out smaller prototypes. Mindful of getting the best financial performance out of their real estate, retailers are more

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likely to demand exclusive use clauses in leases designed to prevent other retailers in the same center from selling similar merchandise.

"If you're in an expensive area like Newbury Street, you're paying premium rent and you want to make sure there's a certain amount of exclusivity," said Peter McGlynn, an attorney with Bernkopf Goodman LLP in Boston. "That's often on the bargaining table. But you've got to be careful. If there are restrictions on use, the courts are going to look at those carefully and make sure they're not overly restrictive."

The practice has long been common among supermarket companies, which typically seek to be the only grocer in a shopping center.

But the expansion of discounters such as Wal-Mart and Target into the grocery business has laid the groundwork for increasing litigation, prompting traditional grocers to withhold rent until a court rules whether their rights have been infringed.

West Bridgewater-based Shaw's Supermarkets took its landlord to court after Wal-Mart installed a dairy cooler in its Falmouth store, claiming its exclusive rights to sell groceries in the same shopping center were violated. The case went to the Supreme Judicial Court, which ruled in the landlord's favor.

As the brick-and-mortar landscape becomes increasingly competitive, more categories of tenants, such as health clubs, are demanding exclusive use clauses, leading to more frequent disputes with landlords.

"Sometimes they're legitimate complaints, and sometimes it's an opportunity to tweak the landlord by saving rent," Pisegna said. "We're seeing more exclusive use clauses and restrictions in shopping centers, so when you see that type of thing, you're going to see some more disputes."

Such clauses can ban sales of particular merchandise, or limit them to a maximum square-footage or percentage of sales, said Paul Bauer, an attorney at Bowditch & Dewey LLP in Boston.

A Ruling Against Landlords

A 2013 Supreme Judicial Court ruling has given landlords more incentive to plan ahead for the early exit of a tenant. The case stemmed from the departure of a dental office from a property in Boston's Downtown



Exclusive lease clauses have long been popular with supermarkets, which seek to be the only grocer in a shopping center.

Crossing in the third year of a 10-year lease.

Typically, a landlord can sue a departed tenant for damages equal to the lost rent, or if they find a replacement tenant, the difference between the two rents. But the SJC ruled that landlord 275 Washington St. Corp. had to wait until the end of the 10-year lease term before it could seek damages.

The reasoning: any estimate of damages would be speculative until the 10-year term was up. The lease didn't contain a liquidated damages clause, so the landlord didn't have that wording to fall back on. While such clauses are common in recent leases, new property owners should review leases to make sure if they're included and seek to amend them, Pisegna said.

The Bankruptcy Trap

Retail landlords scrambled to retain struggling tenants during the Great Recession, often agreeing to rent concessions to keep properties occupied. With the market improving, they're more likely to move aggressively against tenants who fall behind on rent payments, confident that another store will fill the space and pay higher rent.

"The biggest issue is knowing when to act to get a (delinquent) tenant out so you can really not lose too much rent and get that property generating income again," said Marisa Pizzi, an attorney for Bowditch & Dewey.

Average retail rents in Greater Boston rose 4.7 percent in 2014, the sharpest increase in at least eight years, according to a report by CBRE Econometric Advisors. The local retail market is expected to add 2.2 million square feet of net absorption through the end of 2016, the report said.

In the current environment, most landlords in strong markets can afford to be aggressive terminating leases, legal experts say. The goal is to anticipate a tenant's bankruptcy filing, which wipes out most of a landlord's control over the space.

Landlords should keep an eye on tenants' financial and sales reports and prepare to begin the lease termination process before the bankruptcy filing, said Jill Meixel, an attorney for Krokidas & Bluestein.

In bankruptcy, retailers can choose to reject leases on less profitable locations and those leases can be sold in the bankruptcy process, saddling landlords with undesirable replacement tenants. Terminating the original lease, which can be approved by a court in as little as two-and-a-half weeks, gives the landlord the upper hand.

"Termination gives you a lot of leverage," Meixel said. "It doesn't mean you're going to kick the tenant out. It's going to protect you if the tenant files for bankruptcy." ■

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