

Negotiating and Managing Retailers' Exclusive Use Rights

By Steven P. Heller, Esq.

In this unpredictable retail climate, anxious landlords feel that they must accommodate the sometimes expansive leasing requirements demanded by chain retailers and other desired tenants before deals slip away. Meanwhile, retailers, uncertain about proposed store sites, feel that they must secure the strongest sales environment possible — so an exclusive use provision may be critical.

This tension, in the context of exclusive use rights, forces shopping center owners and managers to keep keenly focused on effectively leasing and managing their centers into the future, without becoming entangled in the various competing exclusives.

An exclusive use right is a common provision in retail leases. It protects a retailer's right to sell certain products or services by restricting the landlord from allowing other tenants to do so. Removing the competition incentivizes a retailer to lease space and invest in new business in the center. It also increases the marketability of the retailer's leasehold interest to potential subtenants, creating a plausible exit strategy.

These exclusives, however, present shopping center owners and managers with development and planning challenges. Because exclusives limit the universe of potential tenants, they also shackle a landlord's ability to market the center to maximize rents and obtain the best "tenant mix," ultimately decreasing the value of the project to prospective buyers and lenders. Additionally, prospective tenants may sour on a center that restricts potential lines of sale.

Documenting the exclusive creates other risks. Unclear lease language leads to litigation and creates later opportunities for protected retailers to block prospective tenants who would otherwise fit within the exclusive. Also, property managers sometimes miss an exclusive that's documented in a fragmented fashion — scattered, for example, among a lease amendment and an exhibit on some CC&Rs created years ago.

But landlords routinely take these risks if it means landing a strong retailer.

Containing the Impact on Future Leasing

In lease negotiations, sophisticated parties typically create complex exclusive use provisions that protect the landlord's interests, while maintaining the tenant's critical interest in its exclusivity rights. The simplest approach to exclusives is to not have them at all, a so-called give none, get none approach where a confident retailer will go without an exclusive, conditioned on the landlord's commitment not to give one to any other retailers. This method reduces landlords' problems, but won't work if other retailers in the center already have exclusives, or if other prospective retailers will require exclusives to consider leasing space in the center. Typically, circumstances call for more creative limits.

Items Protected

Define the exclusive with precision to provide a crystal clear guide to future prospective tenants — what can they and can't they sell? For example, an agricultural retailer required an exclusive that restricted

the sale of "items that support a farm/ranch/rural/do-it-yourself lifestyle," which is so vague it could scare off multiple categories of prospective retailers from the center.

Precision grows more critical as retail categories blur further - these days you can buy music at Starbucks and pump gas at the supermarket. Limit the scope of the products/services within the exclusive. A retailer needs protection for its core, primary use, but not for the long list of ancillary uses often requested.

Area and Period Covered. Retailers' exclusivity needs often extend only to a finite portion of the project or time period. A developer may need to exempt from the exclusive a specified portion of the center for future development, or a conceptually separate portion of the center (e.g., retail on the first floor of an adjacent office building) — especially in the current economy, where many redevelopments are on hold, with their future character unknown. Some retailers need an exclusive for the first few years to get established and may agree to relinquish it later to avoid permanently hindering the landlord's leasing efforts.

Continued on back.



Steven P. Heller is a partner at Gilchrist & Rutter in Santa Monica, Calif. He has experience advising shopping center owners and managers on all aspects of real estate transactions, focusing on commercial leasing and development.

Exclusive-Use Rights *continued*

Incidental Use. Another tenant's "incidental" (or minimal) sale of protected items doesn't worry most retailers, depending on what "incidental" means. Landlords should negotiate an exemption for another tenant's "incidental" sale within a limited sales area or for up to a percentage of the tenant's gross sales.

Exempted Tenants

A retailer realistically expects its exclusive won't cover every type of tenant, such as large anchor tenants, very small tenants and already-existing tenants. Anchor tenants often reject any use limits, so one tenant's exclusive rights should not force the landlord to lose a potential lease with a major retailer. Similarly, very small tenants often aren't a competitive threat, so landlords should be permitted to fill small shop space without worrying about exclusives.

Exclusives also should exempt existing tenants — because usually landlords cannot

freely add use restrictions to leases already in place (accordingly, the exclusive should exempt permitted subtenants and assignees under those leases).

Unused Exclusive Rights

Naturally, landlords grant exclusives only to desirable tenants who will enhance a center. However, aggressive retailers contend that, having bargained for an exclusive for the lease term, it should stay intact after the retailer defaults, changes its use, goes "dark"/ceases operation, or even after the lease terminates entirely. Landlords must firmly negotiate the expiration of exclusive rights in these circumstances so that the center is not saddled with both a gaping hole where an anchor supermarket formerly operated and the burdensome restrictions of its exclusive.

Some retailers will agree to give up the exclusive in these circumstances but may demand some concessions. A "dark" retailer will not cede its exclusive rights if the

failure to operate results from renovations or a casualty. A retailer that has changed its use may demand the right to an exclusive for its new use, in exchange for forsaking the exclusive for the abandoned use — subject to other tenants' then-existing exclusive rights.

Generally, landlords negotiating leases with large retailers need to ensure the exclusive provisions are practical in concept and clearly worded. Even if this challenging retail environment forces shopping center owners and managers to negotiate outside their comfort zone to lease up space, they need to precisely negotiate and attentively manage exclusive use lease clauses to avoid future problems.

This article was published in the California Real Estate Journal, September 8, 2008. © Copyright 2008 Daily Journal Corporation. Further duplication without permission is prohibited. All Rights Reserved.