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An Emerging National Issue: Should a Solvent Retail Tenant be Forced to Stay Open?

by Chad J. Richman

A FREEBORN & PETERS LLP CLIENT ALERT

ABOUT THIS CLIENT ALERT:

Two recent cases have inched the meter in favor of landlords seeking to force tenants to stay open.

At the end of 2017, national business media attention was given to two separate trial court decisions: one out of Indiana's Marion County Superior Court and the other out of Washington's King County Superior Court (both trial level courts) when the former granted a preliminary injunction requiring Starbucks Corporation to continue operating failing "Teavana" brand stores in 77 malls in 26 states throughout the U.S. and the latter granted a preliminary injunction requiring Whole Foods to continue operating a failing "365" brand store in a single mall location.

The Starbucks ruling was fast-tracked on appeal directly from the trial-level court to the Indiana Supreme Court (by-passing the appellate level) on the basis that a substantial question of law of great public importance existed or an emergency existed requiring a speedy determination. Legal eagles (such as yours truly) anxiously awaited the outcome of the case. But in January of 2018 Starbucks settled the lawsuit on undisclosed terms. The Whole Foods injunction was stayed and is currently being reviewed by the Court of Appeals of the State of Washington.

I. What have we learned from these two recent rulings?

Despite the media attention, these two cases are not game changers for all retail leases but will serve as persuasive authority and have inched the meter in favor of landlords in factual situations involving profitable non-anchor tenants seeking to close failing locations (while continuing to pay rent) in violation of operating covenants (i.e., "stay open" clauses).

Specifically, credit-worthy and cash-rich retailers[1] seeking to close business units after assuming or signing leases with stated remedies allowing the landlord to obtain specific performance are now at greater risk of being forced to operate than before these two preliminary injunction rulings were entered.

Overall, there is a substantial body of existing case law across the nation ruling both for, and against, injunction motions seeking to force a tenant to stay open following vacation (or attempted vacation) of their space prematurely. A multi-state survey is beyond the scope of this article, but it is safe to say the law generally disfavors the granting of injunctive relief pursuant to an operating covenant, *albeit* to differing degrees depending on the jurisdiction, especially with respect to non-anchor tenants. Such relief is generally viewed as extraordinary, is granted based on the specific facts, and is employed sparingly. The facts in favor of, and against, injunctions are briefly discussed below. Typically courts will require landlords seeking preliminary injunctions to post substantial bonds which may be forfeited if they do not prevail at trial.

II. Some facts in favor of injunction

If a lease allows (or does not prohibit) specific performance and/or other equitable remedies in the event of a tenant default, the door is open for the landlord to seek to force the tenant to stay open.

If the landlord can also demonstrate the tenant is solvent and likely consequences from the tenant's closure are reduced foot traffic at the shopping center, a reduced draw to the shopping center, or co-tenancy breaches triggering lease "outs" for other tenants, those are good facts in favor of an injunction. As detailed in the Starbucks case, the loss of prospective tenants and non-renewal of leases resulting from the impact of the shuttered operations on the curated tenant mix across a large number of malls will be a good fact in favor of the granting of an injunction. Ultimately, if long-term reduced rent, substantial re-tenanting costs (resulting from the possibility of other tenants at the center with similar lease provisions closing or otherwise), and/or diminished reputation of the shopping center are likely to result from the closure, the landlord will have a strong position. An injunction is also more likely to be granted where there is low cost for the tenant to comply with being forced to operate and minimal oversight is needed by the court.

[1] The Indiana Court noted that Starbucks had a market capitalization of over $80 billion and cash-on-hand of $2.7 billion. The Washington Court noted that Whole Foods generates "billions of dollars in profit each year."

III. Some facts against injunction

If the lease is clear that specific performance and/or other equitable remedies are not available to the landlord, the door is *almost* certainly closed for the landlord to force the tenant to stay open (but a court would theoretically still have discretion to trump the lease).

If specific performance and/or other equitable remedies are allowed (or not prohibited) under the lease but the tenant is insolvent and/or will not have a broad impact on the retail environment by vacating (i.e., there will be no ripple/cascading/domino effect to the shopping center or under other tenants' leases), those are good facts against the granting of an injunction- especially where there is a high cost for the tenant to comply with being forced to operate and/or heightened court supervision will be needed to monitor the tenant's forced operations going forward.

IV. The future

Case law will continue to evolve to address specific factual scenarios as failing conventional big-box and mid-box suburban malls are demolished, adapted and re-purposed to "lifestyle centers" that offer non-traditional and non e-commerce uses with experiential/entertainment features that enhance the retail experience by using technology elements for design, construction and management and cater to *millennials* and the "sharing" economy in order to survive internet commerce, urban migration trends and other factors.

These two cases will serve as persuasive authority going forward and have inched the meter in favor of landlords seeking to force tenants to remain open. It is important to remember that contextually these are preliminary trial court decisions which are not controlling precedent outside of their respective States (or, perhaps, even within them) and involve only preliminary injunctions, meaning the merits of the cases could have resulted in different outcomes pending a full review of the evidence.

Bottom line: pay close attention to your operating covenants and the applicable law of the relevant jurisdiction before signing a lease, while negotiating amendments and, ultimately, prior to committing a default (with respect to a tenant) or exercising remedies (with respect to a landlord).

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ABOUT THE AUTHOR

Chad J. Richman

Partner

Chicago Office
(312) 360-6520

crichman@freeborn.com

Chad is a Partner in the Real Estate Practice Group, and has significant experience in a broad range of real estate, finance, transactional, and general business matters. Chad's real estate practice includes acquisitions and dispositions, development, leasing, fund formation, venture structuring, and complex financing involving all types of real estate uses.

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CHICAGO
311 South Wacker Drive
Suite 3000
Chicago, IL 60606
(312) 360-6000
(312) 360-6520 fax

NEW YORK
230 Park Avenue
Suite 630
New York, NY 10169
(212) 218-8760
(212) 218-8761 fax

SPRINGFIELD
217 East Monroe Street
Suite 202
Springfield, IL 62701
(217) 535-1060
(217) 535-1069 fax

RICHMOND
411 East Franklin Street
Suite 200
Richmond, VA 23219
(804) 644-1300
(804) 644-1354 fax

TAMPA
1 Tampa City Center
201 North Franklin Street
Suite 3550
Tampa, FL 33602
(813) 488-2920