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**Seminar 10**

# Making Lease Remedies Great Again; Lessons Learned from Litigating Lease Clauses

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by:


**John J. Wiles, Esq.**
Managing Partner
Wiles & Wiles, LLP
800 Kennesaw Avenue, NW, Suite 400
Marietta, Georgia 30060
jjwiles@evict.net

**Howard K. Jeruchimowitz, Esq.**
Shareholder
Greenberg Traurig, LLP
77 West Wacker, Suite 3100
Chicago, Illinois 6060
jeruchimowitzh@gtlaw.com

**Making Lease Remedies Great Again;**
**Lessons Learned from Litigating Lease Clauses**

This seminar examines remedies when the lease is breached. Often landlords and tenants believe they have an "iron clad" remedy to come to learn that the courts may see it differently than what was intended in the lease. A common area where the parties see the impact is negotiated self-help remedies landlords and tenants possess, such as self-help evictions and repossession of the tenant's property. Another often hard-fought area is remedies for non-monetary breaches, such as breaches of opening and operating, co-tenancy and exclusive covenants and provisions. Finally, what happens to these lease remedies when the tenant files for bankruptcy? This article concludes exploring the options available at the end of the line.

## I. Self-Help Remedies

Landlords and tenants often negotiate self-help remedies in their leases. For example, in commercial leases, landlords reserve the right to re-enter the premises without the need for court process upon a tenant default, termination of the lease or abandoning the premises. Tenants typically reserve the self-help right to terminate the lease and vacate the premises, withhold rent or make repairs. Questions remain as to whether these self-help remedies are enforceable and, if so, are there practical reasons not to enforce them?

### A. Self-Help Remedies For Landlords

"Eviction through legal process is undoubtedly the most secure method." Sol De Ibiza, LLC v. Panjo Realty, Inc., 29 Misc.3d 72, 75 (N.Y. Sup. Ct. 2010). In many commercial leases, however, landlords expressly reserve the right to re-enter the leased premises without resorting to court process upon a tenant's default, termination of the lease or abandoning the premises.[1]

**Practice Point No. 1:** Whether or not a "self-help" remedy is available depends on state law. As of 2014, this is the breakdown:[2]

1. States where common law remedy and not abrogated by statute: Available in at least **11 states** –Alabama, Alaska, Arizona, Hawaii, Maryland, Mississippi, New Jersey, New York, Ohio, Texas and Wisconsin.

2. States where limited to cases of abandonment or other limited circumstances: Available in **7 states** – Idaho, Massachusetts, Missouri, Montana, North Dakota, Virginia and West Virginia.

3. States where the use of self-help is prohibited and commercial landlords are required to only use the judicial process to remove tenants: **District of Columbia and 19 states** – Arkansas, California, Connecticut, Delaware, Florida, Georgia, Illinois, Louisiana, Maine, Michigan, Minnesota, Nebraska, New Mexico, North Carolina, Oklahoma, Pennsylvania, Rhode Island, Tennessee and Washington.

For example, the Illinois courts make clear: "[T]he Forcible Entry and Detainer Act put an end to the practice of self-help and provides the sole means for settling a dispute over possession rights to real property." Fortech L.L.C v. R.W. Dunteman Co., 852 N.E.2d 451, 459 (Ill. App. 1st Dist. 2006). "The

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[1] *See* Adam Leitman Bailey and John M. Desiderio, *"The Availability of Self-Help Evictions to Commercial Landlords,"* Commercial Leasing Law and Strategy (LJN Jan. 2006)

[2] See Howard K. Jeruchimowitz and Martin Kedzoira, "Self-Help Remedies: Are They Really Helpful," ICSC Shopping Center Legal Update (Aug. 2014). The statistics are from 2014 so it would need to be updated to determine if any changes in 2018.

statute prohibits any actual or constructive self-help through force, including changing locks or locking someone out of his land." Id.

4. States where there are no statutes or reported court decisions that prohibit the use of self-help: **13 states** –Colorado, Indiana, Iowa, Kansas, Kentucky, Nevada, New Hampshire, Oregon, South Carolina, South Dakota, Utah, Vermont and Wyoming.

**Practice Point No. 2:** Even in states where the self-help remedy is available, consider whether the landlord should exercise the remedy.

*First*, courts are hostile to the landlord's use of self-help before a tenant can litigate its right to remain in possession.

*Second,* courts will not allow the self-help remedy where it is not explicitly reserved in the lease. For example, in Greaves Lane, LLC v. NBM Development, LLC, the New York State court found that although New York allows the landlord to self-help if expressly reserved in the lease, the lease at issue allowed re-entry and removal only "by summary dispossess proceedings [or] by any suitable action or proceeding at law." 2002 WL 1868882, at *9-*10 (N.Y. City Civ. Ct. 2002).

*Third*, landlords should be cautious in utilizing the remedy because landlords who wrongfully evict commercial tenants prematurely from real property by force or other unlawful means may be liable for damages or compelled to restore possession of the property to the tenant. For example, in *Wagner v. Weaver*, the Ohio Court of Appeals affirmed the trial court's decision to award the commercial tenant the retail value of goods damaged by the landlord's wrongful eviction of tenant where the landlord elected to use self-help by changing the locks on the premises without giving notice to the tenant in violation of the landlord's own lease agreement. 2010 WL 892108 (Ohio App. 3d Dist. 2010). In In re 1345 Main Partners, Ltd., the bankruptcy court restored possession to the tenant because even though Ohio law allows a commercial lessor to resort to self-help repossession, the tenant's technical breach of withholding rent pending resolution of its dispute with the landlord concerning the landlord's removal of lights that the tenant installed did not permit the landlord to declare a forfeiture. 215 B.R. 536, 542 (Bankr. S.D. Ohio 1997).

### B. Self-Help Remedies For Tenants

The availability for self-help remedies to commercial tenants depends primarily upon whether the covenants in the lease are dependent or independent. Traditionally, covenants in leases are independent unless the lease expressly made them conditional and dependent. 15 Williston on Contracts § 44:42 (4th ed.) Under this view, a breach of a lease by a landlord does not justify the tenant in terminating the lease or refusing to pay rent. Id. Most states still adhere to this view.[3] For example, the Illinois Appellate Court recently held that even if the landlord breached the lease, such fact alone did not relieve the tenant of its obligations to pay rent. See Vill. of Palatine v. Palatine Associates, LLC, 2012 IL App (1st) 102707, ¶ 87. Similarly, New York courts consider the obligation to pay rent pursuant to a commercial lease an independent covenant that cannot be relieved by allegations of a landlord's breach. See Universal Commc'ns Network, Inc. v. 229 W. 28th Owner, LLC, 926 N.Y.S.2d 479, 480 (1st Dep't 2011).

On the other hand, some courts have instead adopted the rule of mutually dependent covenants formulated by Restatement (Second) of Property (Landlord and Tenant). See e.g. Wesson v. Leone Enterprises, Inc., 437 Mass. 708, 709 (2002). Under this view, the tenant can terminate the lease and withhold rent if the landlord breaches the lease and thus deprives the tenant of the substantial benefit significant to the purpose for which the lease was entered. Id. In In re Tiny's Cafe, Inc., the court held that

[3] *See* Gary Goldman, *Uniform Commercial Landlord and Tenant Act-A Proposal to Reform "Law Out of Context,"* 19 T.M. Cooley L. Rev. 175, 184 (2002).

the tenant was entitled to withhold rent even where the lease expressly provided that the landlord's failure to maintain the roof "shall not be grounds for the tenant to stop paying rent." 322 B.R. 224, 227-29 (Bankr. D. Mass. 2005). The court held that it would not allow the landlord "to reap an unfair benefit from a clause of the lease that requires [tenant] to pay rent, indefinitely, while he refuses to fulfill his bargained for duty." Id. at 228.

**Practice Point No. 3:** Even where a lease specifically provides for a self-help remedy upon landlord's breach, tenants should use caution before utilizing such remedy.

For example, tenants often invoke a right to withhold the rent when they believe the landlord failed to make repairs or maintain the premises in good state of repair. This is risky. If the court finds that the tenant was not entitled to withhold the rent, the landlord may terminate the lease and evict the tenant. The following case illustrates the risk to the tenant. In South Willow Properties, LLC v. Burlington Coat Factory of New Hampshire, LLC, the court considered whether the tenant breached the lease by replacing the leaking roof without the landlord's permission. 159 N.H. 494, 496 (2009). The tenant maintained that the replacement of the leaking roof was landlord's responsibility, and because the landlord failed to make repairs, the tenant was authorized to replace the roof on the landlord's behalf and at the landlord's expense. The court disagreed and found that because the tenant itself caused damage to the roof, it had an obligation to repair it. Id. at 502. Moreover, the lease required the tenant to submit plans and specifications for the proposed work to the landlord and receive written approval before performing any structural work. The court found that the work bids submitted by the tenant were insufficient, and accordingly the demolition and replacement of the roof constituted a material breach of the lease and grounds for eviction. Id. at 502-03.

### C. Summation

To no surprise, landlords and tenants should know their jurisdiction before using a self-help remedy, even if provided for in the lease. Even when a state allows self-help, commercial landlords should negotiate carefully as the provisions will be evaluated strictly. And, landlords should consider using the judicial process even if the state allows the self-help remedy because of potential damages for a wrongful self-help eviction. Similarly, commercial tenants should consider using the judicial process because of the risk that by improperly utilizing a self-help remedy, tenants themselves may be found in material breach of a lease and evicted.

## II. Non-Monetary Breaches – Opening and Operating Covenants, Co-Tenancy, and Exclusives

There are typically covenants or provisions in the lease known as opening and operating covenants, co-tenancy requirements and exclusives that govern the landlord's and tenant's conduct under the lease. Enforcing these provisions and the remedies for breaches of these provisions often prove to be a challenge.

### A. Opening And Operating Covenants

Opening and Operating covenants are provisions in the lease that would require the tenant to open by a certain date and for that tenant to continuously operate once opened. In the past, leases regularly required that the tenant open and continue operating throughout the term of the lease. The only tenants that did not agree to a continuous operation clause were the major grocery chains. Times have changed though. Landlords often are only able to obtain an agreement from the tenant to open fully stocked and operate for one day. Drafting is pivotal in enforcing the covenant. If tenant is to fully operate, the parties need to define what that terms means. For example, a landlord may want to avoid a situation where the tenant can comply with the operating covenant by staffing a 15,000 square foot space with only one employee and almost empty shelves.

Courts have considered express covenants and implied covenants. When an express covenant is drafted well, courts have considered operating covenants a top priority.

In Rouse-Randhurst Shopping Center, Inc. v. J.C. Penney Co., 171 F. Supp. 2d 824 (N.D. Ill. 2001), the District Court placed operating covenants at the very top of the priorities scale. The court held that the anchor tenant of the shopping center breached the continuous operating covenant when it stopped paying rent after the termination dates applicable if the tenant chose not to renew the lease. In 1990, J.C. Penney assumed the rights and obligations of a lease that originally ended in 1991, which had two key amendments. A 1981 amendment created a new termination date of June 30, 2001 with four consecutive five-year renewal options and also added a covenant of continuous operation under which the lessee agreed to operate continuously a department store on the premises until June 30, 1996 (five years before the then termination date of the lease). A 1989 amendment extended the term of the operating covenant for an additional nine years – until June 30, 2005 (four years beyond the 2001 expiration term).

J.C. Penney found the location unprofitable and ceased operations by the 2001 expiration term. The landlord claimed J.C. Penney was in violation of the continuous operation provision because J.C. Penney ceased operations before June 2005 and, therefore, it was entitled to damages. The court found the provisions clear and unambiguous and not in conflict because J.C. Penny could fulfill the terms of the lease by exercising its first option to extend the terms of the lease or by remaining in possession of the premises as a holdover tenant.

In addition to finding the provisions unambiguous, the District Court went on to emphasize the importance of operating covenants:

> In fact, any analysis of the dynamics of shopping center operations and their leases really places such operating covenants at the very top of the priorities scale.
>
> It is a truism that shopping centers rely for their success on the synergistic effect of their leases, both those running to key or anchor tenants (often department stores) and those running to more specialized lessees occupying smaller premises: Anchor tenants are looked to for the generation of foot traffic and hence of business for the other lessees, and in turn the anchor tenants hope for spillover business from persons who initially come to the center to shop at one or more smaller stores and who decide that, once there, they might as well see what the department store may be offering (sort of the equivalent of impulse buying at the supermarket). That phenomenon, coupled with the related fact that percentage rentals rather than guaranteed lease rentals make the difference between a successful center and a marginal or even failing center, make the prospect of an anchor tenant "going dark"—ceasing to operate—a calamity.

Therefore, even though it was questionable whether the landlord could require J.C. Penney to reopen its store and did not request that relief, the court found the landlord was entitled to damages for the breach of the continuous operating covenant. Various state cases have found that that the landlord has not suffered irreparable harm follows a breach of an operating covenant, but rather the landlord in entitled to monetary relief.

Other courts, however, have issued an injunction to prevent a store closing particularly when the lease provides for such remedy. In a recent example, after Starbucks purchased Teavana and sought to close Teavana stores in shopping venters owned by Simon Property Group where Starbuck had previously signed new leases for the Teavana stores with an express continuous operations covenant. In August 2017, Simon sued Starbucks to prevent the Teavana closings based on an express operating covenant, claiming that it would suffer irreparable harm if Starbucks were permitted to breach the express operating covenant. Simon Property Group, L.P. v. Starbucks Corp., No. 49D01-1708-PL-032179 (Ind. Sup. Ct. 2017). In November 2017, an Indiana state court judge entered a preliminary injunction and

ordered Starbucks to halt closing Teavana stores in 77 retail locations.[4] The Court did so even though acknowledging that "Starbucks noted that no court has ever entered preliminary or permanent injunctive relief to specifically enforce a continuous operations covenant against a non-anchor tenant extending nationwide as requested by Simon here." Starbucks filed an appeal against the preliminary. Before the Appellate Court could rule, Simon and Starbucks reached a settlement regarding the Teavana locations.

**Practice Point No. 4:** On the other hand, courts disfavor an implied covenant.

In an older case, the Minnesota Court of Appeals dealt with whether a lease created an implied covenant for a drug store to continue to operate in the shopping center for the duration of the lease. See Plaza Assocs. v. Unified Dev., Inc., 524 N.W.2d 725 (Minn. Ct. App. 1995). The court made some key observations practitioners should keep in mind in drafting a lease and the impact of the lease on any implied covenant.

(i) As a general rule, the law does not favor implied covenants.

(ii) The courts will imply a covenant if necessary to effectuate the intent of parties. But "the implication must result from the language employed in the instrument or be indispensable to carrying out the intention of the parties into effect."

(iii) Courts are reluctant to impose the burden of a continuous operation clause in the absence of express language because it may "require the lessee to continue operating a business for a long period of time even if that business is incurring substantial losses."

(iv) Factors in that case weighed against an implied covenant for continuous option:

(a) The implication of an operating covenant is less likely where the tenant is paying a "substantial" base rent and a relatively small percentage of gross receipts.

(b) When base rent is "substantial," an implied covenant is less likely if there is a correlation between the base rent and the fair market value of the lease at the time.

(c) The active and extensive negotiations of a lease by sophisticated parties also weighs against finding an implied covenant in a lease "since the parties were free to include whatever provisions they wished."

(d) The failure of a landlord to use an express operating covenant where it has included the covenant in the lease of other tenants, which further weighs against finding an implied operating covenant because it makes clear that the landlord knew how to employ such a clause.

(e) A provision in a lease giving a tenant broad assignment or sublease rights is another factor preventing the implication of an operating covenant because it is inconsistent with an implied obligation to remain and do business.

(f) An implied covenant is less likely where there is no language detailing the scope of the business operation or the identity of the operator.

(g) An exclusive right to operate one's business in the shopping center does not indicate an implied covenant to use the space for the full term of the lease.

**B. Co–Tenancy Clauses**

[4] There were five leases that did not contain an express remedy for specific performance, but Starbucks acknowledged and agreed that injunctive and other equitable relief were agreed remedies available to the landlords.

Co-tenancy clauses are common in retail leases. Their purpose is to provide tenants with a remedy in the event a co-tenancy condition is not met, such as when a specified major tenant fails to open or a certain percentage of occupancy is not achieved at the remainder of the shopping center. From a tenant's perspective such provisions are critical because the tenant is counting on certain co-tenants in the shopping center and a certain foot traffic and business. Small shops really do rely on the ability of the major anchor tenant to draw customers to the shopping center who will also shop at their businesses.

There is usually a co-tenancy for when the tenant is to open and an ongoing co-tenancy. Remedies range from being released from an obligation to open, to rent abatement, or lease termination. From the tenant's perspective, it will want an expansive co-tenancy condition typically tied to a percentage of the GLA of the shopping center and often tied to specific retailer or like replaceable retailers. From the landlord's perspective, it would want a narrower co-tenancy on percentage of gross leasable area built, and want the ability to replace the tenant and backfill the space, as well as impose a time limit for the tenant to remain on reduced rent or to be able to recapture the tenant's space.

**Practice Point No. 5:** Careful lease drafting is essential.

The case of Kleban Holding Co. v. Ann Taylor, Inc., No. 3:11-CV-01879, 2013 WL 6191904 (D. Conn. Nov. 26, 2013) is a good example of the need for careful lease drafting and construction. Ann Taylor leased retail premises in a shopping center in Fairfield, Connecticut. The lease contained a co-tenancy clause that provided:

(a) Opening: the delivery date did not occur until 80% of the retail area of the center was under construction and Borders and two specifically-named major retailers have executed leases, but the landlord may replace the other two specifically-named major retailers with a suitable replacement tenant.

(b) Operating: In the event that Borders or 50% of the retail space, excluding the tenant was not open and operating, the tenant was entitled to abate the rent and instead pay five percent of gross sales until the tenants meeting the foregoing requirements are again open and operating.

Although Borders timely opened and operated, it closed its store on May 16, 2011 in connection with its bankruptcy filing. The landlord replaced Borders with Book Warehouse, which was later replaced by a university bookstore. Two months after Borders vacated the space, Ann Taylor began paying the abated rent.

The landlord initiated the lawsuit seeking full rent under the lease. Ann Taylor contended the lease entitled it to pay reduced rent so long as Borders did not occupy the shopping center. The landlord contended that the lease must be read to forbid Ann Taylor from continuing to pay reduced rent upon the replacement of Borders with another retailer.

However, the landlord was stuck with the abated rent because Border's was out of business. The district court agreed with Ann Taylor finding that the co-tenancy unambiguously provided that Ann Taylor was permitted to pay abated rent under two conditions (a) where Borders is not open and operating or (b) where 50 percent of the remaining retail space is not open and operating. The court further found that Borders could not be replaced by another tenant under section (a) because only the two specifically-named major retailers were replaceable and the lease was silent about Borders, and that under section (b) Borders is specifically listed to mean that Borders, Inc. must be operating. In addition, even though the lease separately provided that the landlord does not warrant that any particular tenant will remain at the center, there was no conflict with the co-tenancy that provided for abated rent if the particular tenant vacated the property.

Typically, the courts find the co-tenancy condition and remedy enforceable without considering extrinsic evidence of financial impact. For example, in Old Navy, LLC v. Center Developments Oregon,

LLC, 2012 WL 2192284 (D. Or. June 13, 2012), the District Court upheld the tenant's rent remedy, that provided that when a "key store" closed, Old Navy was entitled to pay a lower rent of "two percent (2%) of all gross sales made in the premises for each month" or "the amount of minimum rent then applicable." Old Navy had the right to close its doors, but continue paying rent until it decided to reopen, and had the right to terminate the lease if the "Operating Requirements" were not met for more than nine months. The District Court found that such a provision would not be considered a liquidated damages provision, but rather a tiered rent structure triggered if a co-tenancy is not satisfied. The District Court, therefore, did not consider any evidence or argument that the remedy bore a relationship to Old Navy's anticipated or actual damages.

In Hickory Grove, LLC v. Rack Room Shoes, Inc., 2012 WL 1836330 (E.D. Tenn. May 21, 2012), the District Court found that the lease entitled the tenant to pay only 4% of gross sales or the Guaranteed Minimum Rent defined in the lease for a co-tenancy failure. When the shopping center lost a "key client," as defined in the lease, and replaced it with an unqualified tenant, Rack Room decided to stay at the shopping center based on a reduced percentage of sales for the co-tenancy failure. The landlord argued that the co-tenancy provision was punitive in nature and bore no relationship to actual damages suffered by Rack Room. The landlord even offered evidence that Rack Room experienced an increase in sales with the replacement. The District Court did not consider the evidence because: (1) the unambiguous language of the lease did not require the tenant to show decreased sales in order to invoke the co-tenancy provision; and (2) the landlord did not show any evidence of fraud or undue mistake or that the provision was unconscionable.

However, in a case of first impression, the California Court of Appeal ruled that although the co-tenancy clause was not unconscionable, the rent abatement negotiated between the parties was an unenforceable penalty but that the tenant's right to terminate was enforceable. See Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc., 182 Cal. Rptr. 3d 235 (Cal. Ct. App. 2015).

In summary, the co-tenancy provision at issue conditioned the tenant Ross Dress for Less' obligation to open a store and pay rent on Mervyn's (a department store chain) operating a store in the shopping center on the commencement date of the lease. The landlord did not own the Mervyn's parcel. The clause did not have any end date for the rent abatement, nor did it require Ross to pay any rent regardless of whether it was open and operating or not. The provision also granted Ross the option to terminate the lease if Mervyn's ceased operations and was not replaced at that location by an acceptable retailer within 12 months. This opening co-tenancy condition was not satisfied because Mervyn's filed for bankruptcy and did not open its store. Ross took possession of its space, but never opened for business, never paid rent, and terminated the lease after the 12-month cure period expired. The landlord claimed that Ross was obligated to pay rent for the full term because the provisions authorizing rent abatement and termination were unconscionable or, alternatively, an unenforceable penalty.

The trial court agreed with the landlord that the rent abatement and termination under the co-tenancy provision were unconscionable and an unreasonable penalty, and found that Ross breached the lease. The California Court of Appels found that the co-tenancy provision was not procedurally unconscionable and negotiated by sophisticated and experienced parties.

As to the remedies of rent abatement and termination for failure to satisfy the co-tenancy, each remedy was examined separately. Even though the remedies under the co-tenancy provision were negotiated by the parties, the trial court found, and the Court of Appeals affirmed, that the rent abatement provision constituted an unreasonable penalty because (1) the tenant did not anticipate it would suffer any damages from Mervyn's not being open on the lease commencement date and (2) the value of rent forfeited under the provision was approximately $39,500 per month. The Court of Appels held: "There is no reasonable relationship between $0 of anticipated harm and the forfeiture of $39,500 in rent per month and, therefore, the trial court correctly concluded the rent abatement provision was an unenforceable penalty." As to the lease termination provision, however, California courts have adopted a specific rule that holds no forfeiture results from terminating a commercial lease based upon the occurrence of contingencies that (a) are agreed upon by sophisticated parties and (b) have no relation to any act or

default of the parties. Based on those factors, the Court disagreed with the trial court, and found that the termination provision did not create an unreasonable penalty.

Some takeaways from the Grand Prospect case are: (1) this could be limited to a California specific case (no court outside of California to date has cited this case); (2) the rent abatement provision allowed Ross to pay nothing and had no end date even if it opened and operated its store, but the outcome might have been different if the rent abatement had the more traditional percentage off (like 50%), was tied to anticipated sales, or set a definite time; (3) the outcome might have also been different if Grand Prospect had control over Mervyn's space to control whether Mervyn's occupied or operated its business or to find a replacement tenant; (4) the court may have been swayed by the fact that Grand Prospect paid over $2.3 million in tenant improvements before Ross took possession of the leased premises (it is worth noting that if Ross would have been required to taken possession within a reasonable time after the improvements, there would not have been a co-tenancy failure); and (5) the case has opened the door in certain factual circumstances to striking down rent abatement for a co-tenancy failure if it bears no relationship to the harm of the tenant. To be enforceable, such rent abatement must be reasonably related to the lost sales, lost profits, or other damage a tenant anticipates it might suffer if the required co-tenant does not occupy the space or open for business.

### C. Exclusives

An exclusive use or restrictive covenant is a provision typically found in a tenant's lease that obligates the landlord to prohibit other tenants from displaying or selling certain goods or services at other parts of the shopping center, or prohibiting a specific tenant or type of tenant. This is done mainly to keep out competition while affording developers the ability to maintain a balanced and diversified tenant mix. It is essential to protect both landlord and tenant when drafting an Exclusive Right. Considerations: landlord considers tenant defaults, existing uses, notice of default, cure period, rogue tenant and tenant remedies. Tenant considers correct description of use, the length of notice period and the remedies.

**Practice Point No. 6:** State contract law governs the interpretation of restrictive covenants and the enforcement of an exclusive. Thus, the same language in an exclusive could be enforced differently in different states.

Exclusives have been challenged as unreasonable, overly broad, and contrary to public policy. They are strictly construed by the courts and, if the provision is ambiguous, courts will interpret the exclusive narrowly. ***That said, court rarely strike them down as wholly unenforceable and there have been only limited circumstances in which exclusives are deemed invalid***. For example, in Citibrook II, L.L.C. v. Morgan's Foods of Missouri, Inc., a Missouri appellate court recognized that a restrictive covenant cannot continue "forever." 239 S.W.3d 631, 636 (Mo. Ct. App. 2007). In Tippecanoe Assocs. II, LLC v. Kimco Lafayette 671, Inc., the Indiana Supreme Court found that an assignee could not enforce an exclusivity clause preventing landlord from leasing to another grocery store where assignee did not operate a grocery store and used restrictive covenant only as a means to stifle competition. 829 N.E.2d 512, 516 (Ind. 2005).

The most recent and comprehensive case on the power of exclusives is Winn-Dixie Stores, Inc. v. Dolgencorp, LLC saga that started in 2012. In 2014, the Eleventh Circuit weighed in. 746 F.3d 1008 (11th Cir. 2014). This case was in depth analysis as to whether exclusives run with the land and the application of restrictive covenants for "staple of fancy groceries" and "sales area" not defined in the lease. Plaintiff and tenant Winn-Dixie sued competitors and cotenants, Dollar Store and Big Lots, to enjoin their sale of "groceries" at 97 different locations in shopping centers in Florida, Georgia, Alabama, Mississippi and Louisiana where Winn-Dixie was a tenant. The federal district court in Florida and the Eleventh Circuit were forced to address whether the grocery exclusives Winn- Dixie sought to enforce ran with the land under the law of five different states. Both courts also had to define "staple and fancy groceries" and "sales area" under the five different states' law.

The District Court found that the restrictive covenants were enforceable in Florida, Alabama and Georgia, but not enforceable under Louisiana or Mississippi law due to differences in those states

requirements for covenants that run with the land. In applying the Grocery Exclusive, the District Court found the term "staple or fancy groceries" difficult to define, but to include only food and nonalcoholic beverages. The District Court found the term "sales area" to be limited to the footprint of the display unit, excluding aisle space. The District Court declined to imply an additional restriction in the covenant that grocery sales be "incidental to the [defendant's] business."

Given this narrow interpretation, the District Court entered injunctive relief as to only 14 locations, all located in Florida (11 Big Lots stores, one Dollar Tree and two Dollar General). The District Court declined to award injunctive relief for the remaining 83 stores for various reasons, including distinguishing language in the Grocery Exclusives, the fact that some stores were closed, and/or evidence that the stores' sales of grocery items did not exceed the 500 foot limit. The District Court refused to award compensatory damages to Winn-Dixie, finding its damages expert's opinion too speculative. It refused to award punitive damages because the "grocery exclusives sought to be enforced against the Defendants are rife with ambiguities and the scope of their restrictions are uncertain at best."

The Eleventh Circuit affirmed in part and reversed in part certain of the District Court's finding as to the breath or the restrictive covenant and the findings for particular stores. The Eleventh Circuit found that the District Court, applying Florida law, interpreted "staple of fancy groceries" and "sales area" too narrowly as to only food items, including nonalcoholic beverages, and measuring sales area only by shelving space. With respect to 54 of the stores, the Eleventh Circuit relied on the Florida Appellate Court's decision in Winn-Dixie Stores, Inc. v. 99 Cent Stuff-Trail Plaza, LLC, 811 So.2d 719 (Fla. 3d DCA 2002), and found that for the 41 stores in Florida, "groceries" must be read broadly to include food and "many household supplies (as soap, matches and paper napkins)," and sales area "includes fixtures and their proportionate aisle space." As to the remaining 11 stores in Alabama and two in Georgia, the Eleventh Circuit reversed and remanded for interpretation of the covenant terms in accordance with the appropriate law of each of those states. For the remaining 43 states where the District Court denied all relief, the Eleventh circuit affirmed on all grounds, and specifically discussed that the restrictive covenants were unenforceable under the laws of Louisiana and Mississippi. Importantly, the Eleventh Circuit agreed with the District Court's treatment of damages only further confirming difficulty in proving them.

After the Eleventh Circuit's 2014 opinion, the District Court summarized the difficulty of these exclusives:

> I am once again tasked with the job of defining "groceries" as the term is used in a grocery exclusive, which is being applied to variety stores located in shopping centers with a major grocery store. The amount of attorney and judicial time and resources that have been expended in an attempt to define this seemingly simple but evolving term is astounding. After working on this case for over four years, it is apparent that the marketplace is rapidly and continually evolving and grocery stores are selling more and different products than ever before. Crafting a list of products that are considered groceries is a daunting task, especially in light of ever-expanding offerings. This may be a case where I am "faced with the task of trying to define what may be indefinable."

Winn-Dixie Stores, Inc. v. Dolgencorp, LLC, 2015 U.S. Dist. LEXIS 178867, at *7-*8 (S.D. Fla. Aug. 17, 2015). The District Court found that the exclusive was still not violated in Alabama and Georgia because these states did not define "groceries" or "sales area" and, therefore, the Court defined them narrowly to just food and the display unit excluding aisle space. It then had to analyze a broader definition for groceries and sales area under the 2002 Florida 99 Cent case precedent. The District Court divided the Florida stores to pre- and post-2002 99 Cent case. For exclusives before that case, the District Court applied a narrow definition to the exclusive for food only and the display unit excluding aisle space. For the post-99 Cent case, the District Court applied the broader definition which applied to only 14 additional stores. For those stores the District Court interpreted the 99 Cent definition to food and household

supplies" associated with the preparation and service of food, as well as he maintenance of a clean kitchen (as the primary place where food is prepared)."

In a blistering opinion, the Eleventh Circuit spoke again and reversed the District Court as to the Florida stores. Charging the District Court with violating the mandate led astray by Defendants' counsel, the Eleventh Circuit reiterated it really meant for the District Court to apply the broader definitions for groceries and sales area from the 99 Cent case. Winn-Dixie Stores, Inc. v. Dolgencorp, LLC, 881 F.3d 835, 843-45 (11th Cir. 2018). Therefore, the Eleventh Circuit remanded the case yet again (now in its sixth year) to apply the 99 Cent definition to all the Florida stores and adopted the District Court's definition based on the 99 Cent case. Id. at 849-51.

### C. Summation

For the most part, courts will uphold well-drafted opening and operating, co-tenancy and exclusive provisions. Again, it is largely driven by state law. However, as seen by the cases above, the parties never know what they might get as relief in court, especially if the relief is too overreaching or too vague to understand.

## III. Tenant Files Bankruptcy

### A. Tenant Relief Under Title 11 of the United States Code

It is not unusual for an individual or corporate tenant to seek relief under Chapters 7 (liquidation), 11 (reorganization) or 13 (wage earner) of the United States Bankruptcy Code while they continue to occupy the leased premises. Guarantors also file bankruptcy even if the tenant is not in default. Bankruptcy laws are codified in Title 11 of the United States Code and the Bankruptcy Rules, as well as provisions of the Judicial Code relevant to bankruptcy and selected provisions of title 18 of the United States Code regarding Bankruptcy Crimes and Immunity Provisions.

#### 1. The Automatic Stay

Typically, a bankruptcy filing is usually preceded by the tenant failing to pay rent for a period of time. A bankruptcy filing will automatically stay, or stop, any lawsuit or eviction proceeding which is pending against the tenant, and will almost certainly preclude the landlord from legally regaining possession of the leased premises until the Bankruptcy Court has given its permission. The automatic stay provision is contained in 11 U.S.C. § 362. The automatic stay even applies if an eviction is occurring and the tenant informs you it has filed bankruptcy - the eviction must be discontinued immediately. In fact, if you have started the eviction you may be required to put the tenant's property back in its space. Once the tenant files bankruptcy, the tenant is called the Debtor or Debtor in Possession.

#### 2. Lifting the Automatic Stay

If the tenant continues to occupy the leased premises after it files bankruptcy without paying rent to the landlord, or if the landlord has litigation pending against the bankrupt person or entity which is scheduled for depositions or trial, the landlord may make a Motion to Lift the Automatic Stay pursuant to 11 U.S.C. § 362(d). Typically the Landlord's attorney will file a Motion to lift the Automatic Stay, serve it upon the Debtor, the Trustee and the Debtor's attorney and file the original with the Clerk of the Bankruptcy Court. The motion by the landlord (called the Movant) will set forth the facts surrounding the request for relief (for example, that the Debtor is a tenant pursuant to a lease, that the tenant has not paid post-petition rent, that the Movant is prejudiced by the Debtor's use and occupancy of the leased premises without paying rent, and Movant requests the stay be lifted in order to proceed with a State Court action to evict the tenant). Usually, a preliminary hearing on the Movant's Motion to Lift the Automatic Stay is held within thirty (30) to forty-five (45) days after the fling of the motion. Pursuant to 11 U.S.C. §362(e), however, a final hearing must be "concluded not later than thirty days after the conclusion of such preliminary hearing, unless the 30-day period is extended with the consent of the parties in

interest or for a specific time which the court finds is required by compelling circumstances." In fact, a landlord can sometimes obtain a hearing in less time if there is an emergency or this is a repetitive filing. In most districts, attorneys pick the hearing date off of a list of available dates from the Bankruptcy Judge's website, and then file and serve a "Notice of Assignment of Hearing which notifies the Debtor, the trustee and other parties in interest of the date, time and place of the hearing.

In the alternative, if it is the landlord's desire to keep the debtor/tenant in the premises, the landlord can file a Motion to Compel the debtor to pay the post-petition rent. The requirement of the debtor/tenant to pay post-petition rent as and when due is codified in 11 U.S.C. Section 365(d)(3) which provides that, "the trustee shall timely perform all the obligations of the Debtor….arising from and after the order for relief under any unexpired Lease of non-residential real property until such lease is assumed or rejected." See generally, In Re: C.Q., LLC, 343 B.R. 915 (W.D. Wisconsin 2005)

### 3. Stay Relief by Consent

The landlord, the Debtor and the Trustee can mutually agree to lift the stay so the landlord can legally regain possession of the premises, or so that pending litigation may continue, and proceed with depositions, state court hearings or trial. Often times, the Debtor will propose a payment plan which is reduced to a Consent Order providing that as long as the Debtor makes the agreed payments, the Stay remains in force. Importantly, if the Debtor defaults, the Landlord, after notice and a cure period, can have the Stay lifted by submitting an Affidavit of Default and an order to the Bankruptcy Judge. Usually, the Consent Order that no hearing is necessary, so that the Landlord can get stay relief without an expensive evidentiary hearing. In this instance, the landlord can prepare a Motion to Lift the Stay, provide copies to the Debtor and Trustee, and the parties can agree to enter into a Consent Order, setting forth the factual situation and that the parties agree to lift the Stay as to the landlord for the specific purpose stated. A Consent Order not only has the obvious advantage that the parties are already agreeing, saving time and attorney's fees, but, additionally, there is no filing fee by the Bankruptcy Courts to file a Motion to Lift Stay when it is submitted along with a Consent Order.

### 4. Payment of "Stub Rent"

During the period that the tenant is in possession prior to the point when the lease is assumed or rejected, the trustee or the debtor (tenant) is required to timely perform all obligations of the tenant under the lease, including the payment of rent. In the month that the tenant files for bankruptcy, the rent attributable to that portion of the month after the bankruptcy filing is known as the "stub rent period. Depending in what jurisdiction the case is pending, the Bankruptcy Court may order immediate payment of the Stub Rent or, as in some jurisdictions, may order stub rent to be paid at the time of confirmation of the debtor's plan of reorganization and/or at the time of lease assumption. Most Courts hold that stub rent constitutes an administrative claim rather than a post-petition lease obligation requiring timely performance. See In Re: Geonex Corporation and Vernon Graphics, Inc., 258 B.R. 336, 339 (Bankr. D. Md. 2001), "the Trustee is required to pay rent to a lessor under an unexpired, pre-petition lease of nonresidential real property from the date of the filing of the petition until the lease is rejected and the failure to do so gives rise to an administrative claim." Importantly, any rent due for the next full month after the bankruptcy filing is always due timely and in full.

### 5. Proofs of Claim

The way a creditor asserts its right to a claim in the Bankruptcy case is by filing a Proof of Claim. A "claim" is defined by the Bankruptcy Code as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured, or the "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment". 11 U.S.C. § 101(4) and (5). The definition is purposely broad so that all legal obligations of the Debtor can be dealt with in the bankruptcy. 3 Bankruptcy Desk Guide, pt. 6, ch. 22 at 9 (August 1996). The Proof of Claim gives the Debtor, the Trustee, the Court and other Creditors notice that the claim exists. A proof of interest is filed by an Equity Security Holder, commonly a stockholder, one who has the interest of a general or limited partner in a partnership or the interest of a proprietor in a sole proprietorship.

Importantly, a creditor must file a Proof of Claim in order for the claim to be allowed. While there are certain circumstances in which a secured claim need not be filed, and in a Chapter 11 proceeding, a claim may be deemed filed if listed in the Debtor's schedules, it is always best to file a Proof of Claim so there is no question that all interested parties are given notice of the claim. **Practice Point No. 7: If the claim is not timely filed, the creditor's claim may be forever barred!** In addition to filing the Proof of Claim, pursuant to Bankruptcy Rule 3001(c), a copy of the writing (such as a Lease or Guaranty Agreement) should be filed concurrently with the Proof of Claim in order to avoid a possible objection to the Claim by the trustee or the Debtor. If the document is too large, you may state that a copy will be provided on request. You must always redact any Social Security numbers.

### B. Landlord Recourse Under 11 U.S.C. § 365; Assumption and Rejection

This provision of the Bankruptcy Code specifically concerns executory contracts and unexpired leases. The Bankruptcy Code does not provide a definition of an executory contract, and courts undertake a determination on a case by case basis, but the legislative history indicates that an executory contract generally includes contracts on which performance remains due to some extent on both sides, so that contracts are not considered executory where there has been complete performance on one side of the contract. 2 Bankruptcy Desk Guide, pt.5, ch. 20 at 13 (1990).

There generally being little question of what constitutes a lease, the provision of 11 U.S.C. § 365 most important to landlords is 11 U.S.C. § 365(d), which provides a "timetable" for the assumption or rejection of a lease. The Bankruptcy Code makes a distinction between leases for residential real property and non-residential real property as follows: In the case of a residential real property lease, in a case under Chapter 7 the lease must be assumed or rejected within 60 days of the bankruptcy filing, and in a case under Chapters 11 or 13 the lease can be assumed or rejected at any time before the confirmation of a plan.

In the case of a non-residential real property lease, regardless of the bankruptcy Chapter, a lease **must** be assumed or rejected by the **earlier** of 120 days after the date of the bankruptcy filing or the date of the entry of an order confirming a bankruptcy plan. See generally, In Re: Eastman Kodak Company, et al, 495 B.R. 618 (BR. S.D.N.Y. 2013). Importantly, the Bankruptcy Code provides that this time period may be extended by the court, for cause, for one additional 90 day period which essentially means that the Debtor must file a motion with the Court within the initial 120 day period requesting an extension and citing a good cause. After the one-time 90 day extension provided for in the Bankruptcy Code, the Debtor may only receive an additional extension with the express written consent of the Landlord, 11 U.S.C. § 365(d)(4)(b)(ii). In 2005, this rule was changed by Congress, for prior to the enactment of new bankruptcy laws, the time in which a Debtor could extend the lease assumption/rejection deadline was virtually unlimited, so long as the Debtor paid the post-petition rent. The enactment of the new law in 2005 now limits the uncertainty commercial landlords had regarding the assumption or rejection of their leases. Regardless of an extension of time granted by the Court, the landlord always has the right to file a motion, pursuant to Bankruptcy Rules 6006 and 9014, which requests the Bankruptcy Court to compel the Debtor to assume or reject its lease. Often, the Court will grant a large corporate Debtor an extension of time to assume or reject leases because there are scores of leases to be dealt with in the Bankruptcy, and it may take the Debtor some time to assess its leases all over the country. However, as noted above, the Court's ability to grant extensions of time to assume or reject leases has been significantly curbed. No longer can the Court continue giving the debtor multiple extensions, the landlord must consent after the first 210 days of the bankruptcy case.

### C. Rejection of the Lease

For either residential or non-residential leases, if the lease is not assumed within the 60 or 120 day period, respectively, or the time otherwise set by the Court or agreed to by the Landlord and Debtor, the lease is deemed rejected. The decision for a debtor in a non-residential real property setting is a "business judgment" test. See In the Matter of Condominium Association of Plaza Towers, Inc., 43 B.R. 18 (Bankr. S.D. Fl. 1984). Once a lease is rejected, the Debtor has no legal interest in the lease or the leased premises, and the Debtor must vacate the leased premises if it has not already done so. If the Debtor fails

to move out, the best course of action is to file a Motion to Lift the Automatic Stay, for the purpose of filing (or continuing the prosecution of) an eviction action in state court. If the Debtor rejects the lease, the landlord has a claim for "rejection damages" pursuant to 11 U.S.C. § 502(b)(6). The damages are classified as an unsecured, nonpriority claim and are the *greater* of one year's worth of rent under the lease, *or* 15 percent of the balance due over the remaining lease term, not to exceed three years. These damages are not automatically awarded, and must be asserted in a Proof of Claim. See generally, In Re: Winn-Dixie Store, Inc., et al, 381 B.R. 804 (Br. M.D. Fl. 2008)

**D. Assumption of the Lease**

If the Debtor wishes to assume a lease, the Debtor must file a Motion, requesting approval from the Court to assume the lease. In its motion, the Debtor must set forth that the Debtor will cure all arrearages and give "adequate assurance " that the Debtor will promptly cure the default, and continue to perform its lease obligations in the future. 11 U.S.C. § 365(b).

A landlord may object to the Debtor's attempted assumption of the lease, in the form of a written objection filed with the Clerk of the Bankruptcy Court and served on the Debtor, counsel and trustee, in the event that the landlord disagrees with the Debtor's plan to cure the default, or feels that the Debtor has not provided adequate assurance that the default will be cured or that the Debtor will perform in the future.

**E. Assumption and Assignment of the Lease**

Often, the Debtor will want to assume the lease and then assign the lease to another party in accordance with 11 U.S.C. §365(f)(2), and the landlord has grounds to object to the assumption and assignment if the financials of the proposed assignee are questionable (or not provided for the landlord's review), or, in the case of a commercial retail lease, if the proposed assignee's business will violate an exclusive in the Shopping Center or if the landlord is concerned about tenant mix or radius restrictions in the Shopping Center. Importantly, any proposed assignee of the lease must be as credit worthy as the Debtor was when the lease was originally consummated, and further must be able to provide to the Landlord "adequate of future performance" under the terms of the Lease. 11 U.S.C. §365(f)(2).

**F. Termination of the Lease**

Importantly, if a landlord is relatively certain that the tenant is about to file bankruptcy, the best course of action may be to terminate the lease assuming the lease so provides. Though a landlord is giving up its right to future rent and rejection damages, if the lease has been terminated there is nothing for the Debtor to assume. The Debtor will no longer have the legal right to occupy the leased premises, and the landlord should be able to recover the leased premises sooner than if the landlord had to wait for rejection. See In Re: D'Lites of America, Inc., 86 B.R. 299, 301 (Bankr. N.D. Ga. 1988).

**G. Leases of Nonresidential Versus Residential Real Property**

The Bankruptcy Code recognizes that there is a difference between commercial and residential lease matters, in that the potential for economic damage with a commercial lease is higher and therefore, commercial leases are given different treatment under 11 U.S.C. § 365. One distinction between commercial real property and residential real property has been discussed above, that is, the time period for the assumption or rejection of leases. For a commercial real property lease, the lease must be assumed or is deemed rejected within 120 days of the petition date, unless the time has been extended by the Court.

**H. Summation**

Once the Debtor has filed a bankruptcy petition, a notice of commencement of the Bankruptcy is sent to all creditors the Debtor has listed. The notice of commencement will state the date for the Section 341 Meeting of Creditors. The requirement for this meeting of creditors is set forth in 11 U.S.C. § 341, and provides an opportunity for the United States trustee or the Chapter 7 or 13 Trustee to meet with the Debtor and require the Debtors to respond to questions regarding its assets and liabilities. It is also an

opportunity for any creditor who wishes to question the Debtor to do so. This is especially useful if there is a question that the Debtor is hiding assets or has not been truthful in its schedules. Many times, the meeting is a good opportunity to meet with the Trustee and the Debtor's Attorney and discuss payment of rent and tenant's insurance issues.

Additionally, as discussed in detail above, unless the Debtor makes a motion to extend the deadline to assume or reject the lease, the Debtor must assume a commercial lease within the first 120 days after filing, or the lease is deemed rejected, and in the case of a residential lease, in a Chapter 7 Bankruptcy, the lease must be assumed within 60 days or it is deemed rejected.

Importantly, the bankruptcy filing does not change the requirement that the Debtor comply with all terms and conditions of the lease, including paying rent timely to the landlord. 11 U.S.C. § 365(d)(3).