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You're Vaccinated, Now Let's Immunize Your Lease from the Litigators

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I. Introduction

Landlords and tenants often negotiate a lease thinking they have entered an air-tight lease with well-thought out and expressed industry terms that make sense to the parties that entered into the contract. However, when these same parties sue over these leases in court, they are often surprised at how a judge or jury looks at the same contract. In addition to the literal words in the contract, the terms of which parties often are familiar with the courts interpreting as written if they are clear to the court, Judge Posner from the Seventh Circuit Court of Appeals reminds us that:

> One of the [court's] favorite themes is the mischief that results from the abandonment of common sense in contract interpretation. "Common sense is as much a part of contract interpretation as is the dictionary or the arsenal of canons."… "All interpretation is contextual, and the body of

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> knowledge that goes by the name of 'common sense' is part of the context of interpreting most documents, certainly most business documents." … "There is a long tradition in contract law of reading contracts sensibly. Contracts, certainly business contracts of the kind involved here are not parlor games, but the means of getting the world's work done.

Pampered Chef, Ltd. v. Alexanian, 2011 U.S. Dist. LEXIS 139290, *46 - *48 (N.D. Ill. Dec. 5, 2011) (quoting Judge Posner in *Dispatch Automation, Inc. v. Richards*, 280 F.3 d 1116, 1119 (7th Cir. 2002); *McElroy v. B.D. Goodrich Co*., 73 F.3d 722, 726-27 (7th Cir. 2002); *Beanstalk Grp., Inc. v. AM General Corp*., 283 F.2d 856, 860 (7th Cir. 2002)). *See also generally* Richard A. Posner, How Judges Think, 116 (2008).

This general session will explore how litigated lease provisions have been interpreted and applied by the court and, when analyzing those applications, the general session will further explore if there is a way to draft a lease to immunize it from litigation or, if in litigation, from the court's own interpretation of the lease. This article (i) provides an overview of how courts interpret contracts generally, and will apply those rules to your leases (even though retail leases are a very unique type of contract), (ii) examines situations where leases are litigated, including defaults and damages, use and prohibition clauses and its impact on morphing and modernized shopping centers, and maybe a new wave of litigation about crypto currency; (iii) analyzes how implied covenants not even in the lease may bind the parties including first-class obligations, the implied covenant of good faith and fair dealing and the implied covenant of the failure to operate; (iv) looks at boilerplate provisions in the leases that parties rarely negotiate or even understand that could come back to haunt them later; and (v) forecasts potential issues regarding recession and the future of metaverse leasing.

II. Overview of Lease Interpretation

A. How Courts Interpret Leases

Even though shopping centers are, "for the most part, a post-World-War II development … the rules by which we construe documents are ancient and no logical basis for having one set of rules for shopping centers and a different set of rules for other contractual relationships." Crest Commercial, Inc. v. Union-Hall, Inc., 243 N.E.2d 652, 657 (Ill. App. 1968). For many years, some courts used real estate principles in interpreting shopping center leases, such as with respect to restrictions, but courts changed that view and "applied contract-law principles for determining the intent of the parties." *J.C. Penney Co. v. Giant Eagle, Inc*., 85 F.3d 120,123-25 (3d Cir. 1996).

In firmly applying contract principles, "[t]he best evidence of what parties to a written agreement intend is what they say in their writing." *Greenfield v. Philles Records, Inc*., 780 N.E.2d 166, 180 (N.Y. 1992). Therefore, if transactional lawyers and the parties to the lease drafted clearly, then presumably courts are limited to look to the intent of the parties through the "four corners" of a contract if the court does not find the contract ambiguous because the court "can give it a certain or definite legal meaning or interpretation." *See, e.g., Potts v. Chesapeake Exploration, L.L.C*., 2013 U.S. Dist. LEXIS 33264, *10-*11 (N.D. Tex. Mar. 11, 2013). "The first rule that courts must apply when construing contracts, including real estate contracts, is to look to the plain meaning of the words of the contract." *D. R. Horton, Inc. – Torrey v. Tausch*, 610 S.E.2d 151, 152-53 (Ga. Ct. App. 2005). "Pursuant to the 'four corners' rule of contract interpretation, a written agreement 'must be presumed to speak the intention of the parties who signed it. It speaks for itself, and the intention with which it was executed must be determined from the language used. It is not to be changed by extrinsic evidence.' " Cananwill, Inc. v. T.J. Adams Group, LLC, 2013 IL

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App (1st) 111604-U, ¶ 40 (quoting *Air Safety, Inc. v. Teachers Realty Corp.*, 185 Ill.2d 457, 462, 706 N.E.2d 882 (1999)).

Of course, the parties are stuck leaving to the interpretation of the judge in a case and his or her impression as to whether the "four corners" of the contract are clear and unambiguous. If the court finds that contract terms are ambiguous or if the contract is not fully integrated, courts will turn to parol evidence (*i.e.*, other outside evidence not contained in the contract, such as the negotiations, prior or contemporaneous drafts and communications, industry custom and practice). A lease is not ambiguous simply because "the parties advance different interpretations." Potts, 2013 U.S. Dist. LEXIS 33264, at *10. But just because your contract contains boilerplate language such as "Entire Agreement," "Integration," and/or "Merger" sections, expressly indicating that the parties desire and intend to have the four corners doctrine apply, a court can still go outside of the four corners if it finds an ambiguity and believes parol evidence is necessary to construe the contract or determine the parties' intentions.

The Restatement (Second) of Contracts is instructive. Section 213 provides:

<u>Effect Of Integrated Agreement On Prior Agreements (Parol Evidence Rule)</u>

1) A binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them.

2) A binding completely integrated agreement discharges prior agreements to the extent that they are within its scope.

3) An integrated agreement that is not binding or that is voidable and avoided does not discharge a prior agreement. But an integrated agreement, even though not binding, may be effective to render inoperative a term which would have been part of the agreement if it had not been integrated.

Notably, evidence of prior or contemporaneous agreements or negotiations is not admissible to contradict a term of the contract at issue, so evidence of a prior agreement is, therefore, irrelevant to interpreting the term of the current writing. That same evidence (i.e., a prior contradictory agreement), however, may be properly considered on the preliminary issues whether there is an integrated agreement and whether it is completely or partially integrated. The parol evidence rule applies only when a contract is completely finalized, or "integrated." Section 209 of the Restatement (Second) of Contracts defines an integrated agreement as follows:

1) An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement.

2) Whether there is an integrated agreement is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.

3) Where the parties reduce an agreement to a writing which in view of its completeness and specificity reasonably appears to be a complete agreement, it is taken to be an integrated agreement unless it is established by other evidence that the writing did not constitute a final expression.

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A signed lease may include an explicit boilerplate provision stating that that there are no other agreements between the parties, but such a provision may not be conclusive. When a contract is fully integrated, parol evidence is inadmissible even to add terms not inconsistent with the writing. Ironically, in determining whether an agreement is completely or partially integrated is to be determined by the court as a preliminary question and may itself involve application of the parol evidence rule. Specifically, in the instance of a partially integrated agreement, extrinsic evidence of prior negotiations or agreements is allowed to supplement, but not contradict, the contract.

Therefore, resolving any ambiguity within a contract term is a threshold question of law for the court to decide. *Duane Reade Inc. v. St. Paul Fire and Marine Ins. Co.*, 411 F.3d 384, 390 (2d Cir. 2005); *Rhone-Poulenc Basic Chemicals Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1195 (Del. 1992). Courts generally will try to resolve any ambiguity through analysis of the four corners of the contract alone, thereby actually concluding that there is not, in fact, an ambiguity, but simply a provision requiring interpretation by reference to other parts of the contract. *Sun Oil Co. v. Madeley*, 626 S.W. 2d 726,728 (Tex. 1981).

Ambiguity typically requires a finding that the contract language is reasonably susceptible of more than one meaning, applying a reasonable person standard to this analysis (and not the parties' own subjective interpretations). *Lightfoot v. Union Carbide Corp.*, 110 F. 3d 898, 906 (2nd Cir. 1997). However, a party's understanding of the given term at the time of contracting (i.e. their subjective contemporaneous definition) may be important if the term is a word with a double meaning and can prove its ambiguous nature. Only if a court has first made the determination that a contract is ambiguous, may the court consider the parties' interpretation, intentions, and potentially admit extraneous evidence to determine the true meaning. *Nat'l Union Fire Ins. Co. v. CBI Indus.*, 907 S.W. 2d 517, 520 (Tex. 1995).

Additionally, "[w]hen the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court. Restatement (Second) of Contract § 204 at 96-97 (1981). The fact that an essential term is omitted may indicate that the agreement is not integrated or that there is partial rather than complete integration. In such cases the omitted term may be supplied by parol evidence (e.g., prior negotiations or a prior agreement). However, omission of a term does not necessarily show that integration was not complete, particularly if the binding contract discharges prior inconsistent agreements. Courts are often hesitant to supply missing terms by relying on parol evidence and instead often elect to stay within the four corners of the document, apply a standard of plain meaning to the express terms of the contract, and deduce the parties' intent from the express written language of the document.

Obviously, the clearer the parties are in the lease, the more likely the courts will be able to decide the dispute based on the fully integrated contract. But, as one can expect, the fact that the parties are litigating the dispute in the first place may open the leases to varied determinations and outcomes when left to the interpretation of the courts.

B. Company Retention

The deal is done. The reaction might be that the parties can dispose of their drafts. The company likely has routine document retention/destruction and email auto deletion policies. However, these drafts and communications might be pivotal if a lease were to be disputed. If a court were to find a lease ambiguous, some of the key evidence could have been the prior drafts and communications during the negotiations. And yet the key evidence could be lost, leaving the court to interpret the lease without the

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key evidence. Although it is unlikely that a company would preemptively change its policies to keep such documents even though it should consider doing so, it must certainly do so if there is even a hint of a dispute brewing. This would require a litigation hold for the company personnel to preserve documents. Failure to preserve such documents could lead to finding of spoliation *See, e.g., Bankdirect Capital Fin., LLC v. Capital Premium Fin., Inc.*, 2018 U.S. Dist. LEXIS 57254, * 7 (N.D. Ill. Apr. 4, 2018) ("While a party's failure to issue a litigation hold does not inevitably constitute spoliation, it can be part of a mosaic of evidence leading to a finding of spoliation."); *Oleksy v. GE*, 2011 U.S. Dist. LEXIS 87271 (N.D. Ill Aug. 8, 2011) (because of discovery of a data purge, discovery allowed into document retention policies, litigation hold letter, documents of steps party took to institute hold even without bad faith). Sanctions could range from monetary sanctions to an adverse inference finding to exclusion of evidence.

III. Leases on Trial

Inevitably, even the best intentioned, fully negotiated leases lead to litigation. The litigation may focus on a particular term in the lease in dispute, a situation that neither party anticipated occurring during the term of the lease, or a change in financial position in one of the parties or the viability of the property itself which upsets the apple cart. In such times, all the parties are left to deal with are the four corners of the lease, the default and notice provisions, and the remedies one party or the other may be entitled to depending on who is right. The below demonstrates some of the lesser known and often overlooked issues in leases that have arisen recently, as well as the remedies afforded to the parties under the lease and/or common law.

A. I Signed a Lease, But Now I Don't Want to Do the Deal or Take Possession- Have I Breached a Contract or a Lease?

What happens if a landlord and tenant both sign a "Lease," but prior to the Lease commencement date, the tenant informs you that it no longer wants to lease the property? Do you have a breach of lease case (for which your remedy is your heavily negotiated liquidated damage clause) or will you be stuck with contract remedies which may not be as helpful to you or which will require you to mitigate your damages, whereas a lease would not do so. Courts continue to grapple with "what is it" depending upon the timing of the default and the circumstances of the default.

In *Arthur Treacher's F.C. v. Chillum*, the tenant failed to take possession of leased space prior to the lease commencing. The landlord sued the tenant for breach of the lease, but the court found that what makes a lease different than a contract is that an interest in real estate is created by virtue of giving over possession of the space to a tenant. Thus, because the tenant did not take possession even though it signed what was styled as a "Lease," the landlord would only be able to sue for breach of contract as compared to a breach of lease. 29 Md. App. 320 (1975). Likewise, in *Latham Land I, LLC v. TGI Friday's, Inc.*, 948 N.Y.S.2d 147 (App. Div. 2012), TGI Friday's agreed to build a restaurant and lease it back from the landlord for a 10-year term in the Town of Colonie. *See id.* However, following entering the lease, TGIF decided to forgo building and informed the landlord it would not perform. The landlord could not find a new tenant and ultimately sold the property and sued TGIF for damages. *See id.* The court and the plaintiff conceded that because TGIF never took possession of the lot and began construction, a leasehold was not created and the landlord's damages would be common law contract damages. *See id.*

However, in *150/160 Assocs. v. Mojo-Stumer Architects, Inc., P.C.*, the parties entered into a 10-year lease, but prior to the commencement date the tenant repudiated the contract. 571 N.Y.S.2d 520 (App. Div. 1991). The landlord was able to find another tenant a couple of months later who would pay higher rent, but sued to recover the damages incurred under the lease during the interim period. The

court, in that case, found that despite the lease never commencing, the landlord could avail itself to the remedies in the lease to collect the interim rent due to tenant's repudiation of the lease even though it had done so prior to the lease commencement date. *Accord, W&G Seafood Associates, LP v. Eastern Shore Markets*, Inc., 714 F. Supp. 1336 (D. Del. 1989).

Thus, whether the tenant breaches a lease or a contract varies based upon jurisdiction, contractual language (if any), and basis for the breach. Given the disparity in how courts have treated pre-possession breaches, the safest way for both parties to have clarity as to what remedies would apply should tenant default prior to taking possession is to simply write the specific remedy agreed upon by the parties for such breaches. For instance, the default section of the lease should be based upon "Prepossession and Post-Possession Defaults" rather than staying silent and only discussing what remedies will apply after the lease commences. Oftentimes, the lease will not have commenced, and the default has already occurred, and in such cases, should the landlord want to recover the full expectancy of its bargain and/or his liquidated damage clause, it should make it clear that such remedies apply even if the lease commencement date has not yet occurred.

B. I Know I Said I Would Pay Rent, But Your Interference with My Expectations Constitutes a Partial Eviction and Now You Can't Remove Me or Make Me Pay Rent.

During the course of the last several years, new builds and mixed-use projects stalled whether due to demand, labor shortages, or delays in construction caused by supply chain difficulties or other concerns. In this time period, a rarely used type of claim has been asserted more frequently by tenants in an effort to abate their own rent while not worrying about the threat of being kicked out of the space: "partial eviction," Partial eviction affords a tenant with the right to remain in the premises (provided it is not the area allegedly interfered with) and abate rent if the landlord has interfered with its beneficial right and enjoyment of its premises or some portion of it. *Westbury Flats, LLC v. Backer*, 130 N.Y.S.3d 631 (2020)(negligent repairs made to the building causing sagging in floors was a partial constructive eviction as it interfered with tenant's beneficial use of the premises); *Board of Managers v. Integrated Medical Professionals*, 119 N.Y.S.3d 15 (2019) (stating for a constructive eviction to be partial, rather than total, the tenant must abandon only the portion of the premises affected). To that end, the interference by the landlord could arise from temporary interference with the access to tenant's store, the parking lot which most of the customers use, or any other common area which the tenant claims it materially relied upon as being unencumbered for its operation of its business under the lease. *See, e.g.*, 119 N.Y.S.3d at 15.

While constructive eviction typically requires a tenant to move out of the premises and then sue the landlord for the breach, partial eviction does not in some jurisdictions. *See e.g., Giraud v. Milovich*, 85 P.2d 182, (Dist. Ct. App. CA 1938); *Westbury Flats, LLC v. Backer*, 130 N.Y.S.3d 631 (2020) (stating "[w]hen determining the substantiality of a partial constructive eviction, the extent of the intrusion or interference with lessee's use and quiet enjoyment of leasehold are factors to be considered based upon the very specific circumstances. Therefore, each case for commercial tenant abatement is indeed fact specific.... [and] [c]onstructive eviction exists where, although there has been no physical expulsion or exclusion of the tenant, the landlord's wrongful acts substantially and materially deprive the tenant of the beneficial use and enjoyment of the premises"); compare *Fieldstone Capital v. Ryan & Conlon, LLP*, 104 N.Y.S.3d 823, (1st Dep't, NY 2019); (stating alterations to leased premises, made with the consent of the tenant, do not amount to an eviction, no matter how extensive or the degree of interference with the tenant's occupancy).

A tenant claiming partial constructive eviction may remain in the premises and abate all of its rent and thereafter litigate the merits of the purported interference for years while the landlord's operating

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income from the space becomes non-existent. *See e.g.*, Frame v. Horizons Wine & Cheese Ltd., 467 N.Y.S.2d 630 (App. Div. 1983). As the Court of Appeals in California adopted this general rule, it stated:

> When the eviction is of a part of the premises only, and is by the landlord himself, this, according to the generally accepted view, will relieve the tenant from liability for future rents, though he remains in possession and enjoyment of the balance of the premises and the law will not in such a case apportion the rent….As has been said the landlord cannot so apportion his own wrong as to force the tenant to pay anything for the residue….So an action for use and occupation cannot be maintained after such a partial eviction, as the lease is not terminated by the unlawful eviction. He continues to occupy that part of the estate from which he has not been evicted, under and by virtue of the lease, and no implied promise to pay arises. Not only does a partial eviction by the landlord preclude the recovery of rent accruing subsequent to the eviction and while the eviction continues, but it also suspends the right of the landlord to maintain proceedings to remove the tenant for the nonpayment of rent, as the tenant ceases by the act of his landlord to become liable legally for the rent.

Giraud v. Milovich, 85 P.2d 182 (Cal. Ct. App. 1938) (citations throughout omitted). Thus, not only can tenant remain in the premises rent free, landlord cannot seek to remove tenant, and tenant can seek its lost profits and/or the value of the difference in value of its tenancy with and without the interference from landlord. *See e.g., Commerce Park Assoc., LLC v. Robbins*, 220 A.3d 86 (Conn. App. Ct. 2019).

Thus, constructive partial eviction claims are very powerful tools tenants can use to attempt to abate their rent by law while at the same time remaining in the premises. Moreover, most leases do not address "partial evictions" and typically only carve out cases of constructive eviction as an exception to the payment of rent. Thus, from a practical standpoint, in order to prevent being stuck with a tenant who stops paying rent, landlord's counsel is wise to try and include language in its lease which provides that irrespective of any alleged interference with tenant's beneficial use and enjoyment of the premises, tenant agrees to pay rent, and it waives any and all claims of partial eviction that could be asserted during the lease term.

C. I'm Out of Here: What Damages Do I Really Owe (Liquidated Damages, Rent Acceleration, Penalties)

Liquidated damages are a pre-determined, stipulated amount of damages within a contract that apply upon the occurrence of an event, which can include a breach of contract by one party if such event or if a breach occurs at all. They are favored by the parties to a contract for "certainty" purposes, but they are only enforceable under circumstances where the parties can only estimate the damages, such estimate is reasonable, and the circumstances in which liquidated damages are utilized does not violate public policy. Liquidated damages that constitute a penalty are unenforceable. Courts are generally willing to uphold liquidated damages provisions between commercial parties in written contracts so long as the amount bears some reasonable proportion to the probable loss, but the amount of the loss itself is not incapable or would be difficult to estimate or calculate, and neither party wielded greatly unequal bargaining power at the time of contracting. In retail leasing, liquidated damages are most often seen as a measure of damages when a tenant that is subject to an operating covenant goes dark, but it can be found in a multitude of circumstances.

Commercial leases routinely provide for a landlord remedy of lease termination following an uncured tenant default, as well as recovery of rent damages. Among those rent damages, most leases include future rent damage for anticipated loss of rental stream, for some or all of what would have been the remaining term of the lease had the landlord not terminated the lease. Pure rent acceleration clauses enable a

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landlord to collect all rent payable after the termination of a lease, as a one-time lump sum payment. Variations include discounting this amount to present value, reducing this amount by fair market rental value for some or all of the remaining term, or stipulating in the lease that the landlord will be entitled to accelerate rent for some finite period of time immediately following termination during which the parties stipulate and agree the landlord will be unable to relet the space and get a replacement tenant to commence paying rent (in exchange for which neither the tenant has the obligation to prove fair market rental value, nor does the landlord have to demonstrate any efforts to mitigate its damages).

Trustees of Columbia University in the City of New York v. D'Agostino Supermarkets, Inc., 36 N.Y.3d 69 (2020)

This case involves the enforceability of a liquidated damages provision in the context of a surrender agreement entered into after a lease termination. Landlord is a university that had rented space for use as a supermarket under a 2002 lease. In 2016, tenant stopped paying rent under the lease and later that year the parties entered into a surrender agreement pursuant to which tenant agreed to make a lump sum payment and additional monthly payments, totaling the rent arrears (roughly $260,000). The surrender agreement further provided that if any payment was unpaid beyond five days following notice of default, then all rent that would have been due under the lease would be accelerated. After paying the lump sum payment, tenant failed to make the additional monthly payments and landlord commenced suit seeking to accelerate the rent under the lease.

All levels of the court (including New York's highest court), found this acceleration of rent unenforceable, because, in this context, the damages at the time of the surrender agreement were ascertainable (i.e., the balance due of the stated amount due under the surrender agreement) and the accelerated rent amount far exceeded the landlord's actual damages (i.e., being an amount over 7 times the amount that Landlord would have received if the surrender agreement had been fully performed). Specifically, the court noted that the landlord here had elected to enter into the surrender agreement instead of suing for a breach of the lease in the first instance (which would have allowed landlord to pursue future rent under the lease), but by doing so, landlord gained the ability to immediately reenter and relet the premises (and, thereby, derive income therefrom) without the need for litigation. As such, landlord had relinquished its right to acceleration under the lease and tenant was relieved of obligation to pay any future rent. The surrender agreement was viewed as a new contract between the parties and the "accelerated rent" was viewed as a liquidated damages provision solely as it related to the contractual obligations under that new contract (i.e., the surrender agreement) alone.

Practice Pointer: A lease amendment, accelerating the expiration date, can achieve the same result as was attempted here, without terminating the lease, prior to full payment of any agreed amount. A lease amendment continues the lease in full force and effect, with an acceleration of what is scheduled to be the expiration date to occur upon the happening of certain conditions precedent (i.e., payment and physical surrender). If the conditions do not occur, then the lease remains in effect, and landlord retains all right and remedies (and, for that matter, tenant retains a leasehold estate and the rights, as they may be, to assign and sublet).

723 Edibles, Inc. v. 721 Borrower, LLC, 2021 N.Y. Misc. LEXIS 4486 (N.Y. Sup. Ct. Aug. 18, 2021)

In this case, the Supreme Court of New York for New York County came to an opposite conclusion to the New York Court of Appeals in *Trustees of Colum. Univ. in the City of N.Y. v. D'Agostino Supermarkets, Inc.*, 36 N.Y.3d 69 (2020). 723 Edibles, 2021 N.Y. Misc. LEXIS 4486, at *5–*6. In D'Agostino, the high court of New York found that a liquidated damages provision in a lease agreement

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was unenforceable as the amount was over 7 times the amount that the landlord would have received if the surrender agreement had been fully performed. *Id.* at *5. The trial court here distinguished 723 Edibles from D'Agostino, explaining that in the instant case, the liquidated damages clause only entitled the landlord to an amount that was twice the monthly rent. Id. The court found that this lower damage amount did not constitute an unenforceable penalty that violated public policy but was valid in the context of a commercial tenancy. *Id.*

Camp St. Crossing, LLC v. AD IN, Inc., 2021 Ill. App. Unpub. LEXIS 1990 (Nov. 15, 2021)

In this case, the Appellate Court of Illinois for the Third District assessed whether a liquidated damages provision in a lease requiring the lessee to pay one-and-one-quarter times rent when they abandoned a commercial property was enforceable. Camp St. Crossing, 2021 Ill. App. Unpub. LEXIS 1990, at ¶ 1. In 2013, the parties had entered into a 10-year commercial lease for the lessee, AD IN, Inc., to operate an Edible Arrangements. *Id.* at ¶ 2. Under the agreement, the lessee's monthly rent payments would increase incrementally each year after May 1, 2019. *Id.* at ¶ 5. The parties agreed that in the event the tenant abandons the space, the tenant would pay one-and-one-quarter times rent in "liquidated damages" during the time they were absent. *Id.* at ¶ 6. Thereafter, the tenant failed to pay rent on time in December 2018, January 2019, and August 2019. *Id.* at ¶ 8. The tenant vacated the premises without notice on August 10, 2019. Id. The landlord brought suit against the plaintiff for breaching the lease, and the trial court entered summary judgment for the landlord for one-and-one-quarter times rent as the lease specified. *Id.* at ¶ 18.

The appellate court reversed the holding of the trial court, finding that the amount of damages for the tenant's breach was readily "ascertainable" and that the liquidated damages provision effectively functioned as a "penalty" that the court declined to enforce. *Id.* at ¶ 46. The court first explained that that when assessing contract provisions detailing specific damages, there is a distinction between liquidated damages, which courts will uphold, and penalties, which are unenforceable. *Id.* at ¶ 41. This is based on sentiments of public policy, as courts find that the purpose of damages is to place the non-breaching party in the same position as if the contract had been performed, not to punish nonperformance. *Id.* at ¶¶ 41, 43 (citing *Union Tank Car Co. v. NuDevco Partners Holdings, LLC*, 123 N.E.3d 1177, 1187–88 (Ill. App. Ct. 2019)). In Illinois, a liquidated damages provision is valid and enforceable when: "(1) the parties intended to agree in advance to the settlement of damages that might arise from the breach; (2) the amount of liquidated damages was reasonable at the time of contracting, bearing some relation to the damages which may be sustained; and (3) actual damages would be uncertain in amount and difficult to prove." Id. at ¶ 42 (*citing Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Trust Co.*, 607 N.E.2d 1337, 1345–46 (Ill. App. Ct. 1992)). In the instant case, the court found that the damages were ascertainable since the lease specified the rent and other amounts the tenant would owe had it continued to operate on the premises. *Id.* at ¶ 46. The court found the liquidated damages clause to be an inappropriate penalty as the landlord could be restored to the same position as if the contract had been performed by receiving the rent it would have been paid. *Id.*

In a separate concurring opinion, Justice Holdridge lamented the "inartful drafting" of the lease. *Id.* at ¶ 52 (Holdridge, J., concurring). Under the lease, when the one-and-one-quarter times rent payments were paid to the landlord, they would be held in trust by them, used to recover the landlord's damages, and then the excess would be returned to the tenant. *Id.* Justice Holdridge explained that under this operation, the lease was ambiguous as to whether the "liquidated damages" language should be treated as a penalty or a deposit. *Id.* at ¶ 53. Where language in a contract is ambiguous, it should be construed against the drafter of the language, in this case, the landlord. *Id.* (citing *Sherwood Commons*

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Townhome Owners Ass'n, Inc. v. Dubois, 148 N.E.3d 900, 912 (Ill. App. Ct. 2020)). Due to this ambiguity, the lease provision should have been interpreted as an unenforceable penalty. Id.

Leeber Realty LLC v. Trustco Bank, 798 Fed. Appx. 682 (2d Cir. 2019)

This case involves the enforceability of a rent acceleration provision without any offset for reletting proceeds. Specifically, tenant argued that under the lease the rent acceleration clause was not enforceable because the landlord was not required to relet the premises or to apply the proceeds of reletting to the benefit of tenant. Here, the court held that the landlord is not required to mitigate damages in the event of a tenant breach but did not apply the rent acceleration provision to the five-year extension option period, limiting acceleration to only the 20-year initial fixed term. Despite the parties unambiguously exercising the option, the court construed the capitalized term “Lease Term” as used in the lease, not to include an “Option Term.”

Note: Although black letter law (and in this instance, New York law) does not require that commercial landlords have any obligation to mitigate their damages, in many jurisdictions, there is a statutory or common law duty to mitigation damages (or both), and often this cannot be waived by contract.

Star Development Corp. v. Urgent Care Associates, Inc., 529 S.W.3d 487 (Mo. App. Ct. 2014)

This case addresses the enforceability of a late charge fee provision within a commercial lease. Here, the landlord sought damages from a former commercial tenant for various items of rent, plus late charges after the tenant terminated a month-to-month tenancy following a holdover after the expiration of a written shopping center lease. The lease between the parties required tenant to pay a late charge equal to 15% of any payment that was not made by the tenth (10th) day of any month. In determining whether such late charge provision was an enforceable liquidated damages clause or an unenforceable penalty clause, the court pointed to the express language of the lease that stated the intent of the late charge was to compensate landlord for any administrative expenses it would incur if rent was not paid on time. The court also found that the 15% late charge assessed was a reasonable forecast of damages to compensate landlord for its administrative efforts in generating a report, discussing past due status, and attempting to contact tenant each month rent was late (for which tenant habitually was late). Such administrative efforts constituted the necessary “actual harm” element of the court’s analysis supporting liquidated damages.

Additionally, tenant argued that landlord waived its right to collect the late charges when it accepted late rental payments without notifying tenant that its payments were late, or subject to the late charges, and without always seeking recovery of the late charges over the course of the five-year lease period which included 39 late rental payments. The court rejected this argument, noting that the provision contained no time limit on such recovery and the lease included a no-waiver boilerplate clause.

Hand Cut Steaks Acquisition, Inc. v. Lone Star Steakhouse & Saloon of Neb., Inc., 298 Neb. 705 (2018)

In this case, the landlord leased the property to the tenant for a 66-month term, to run from 2010 through 2016. In October 2012, the tenant notified the landlord that it planned to shut down its restaurant but continued paying rent through February 2013. The tenant stopped paying rent in March 2013 and the landlord demanded that the tenant surrender the premises. The tenant surrendered the premises in early May and the landlord began receiving inquiries about the availability of the property. In June 2013, landlord signed a letter of intent outlining the terms of the sale of the property for $1.715

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million to a new buyer. However, it took until September 2013 for the parties to finalize the purchase agreement for the property and, due to issues with title insurance, until April 2014 to close the sale. For the purpose of mitigation and damages, the court found that the accrual of damages ended when the landlord signed its letter of intent to sell the premises to the new buyer on June 13, 2013. Thus, the district court awarded money damages against the tenant in the amount of $49,415.27. *Id.* 709-15.

The appellate court held that an abandonment of a leased premises by a tenant constitutes an offer to terminate the lease. Whether there has been an acceptance by the landlord of the tenant's abandonment is largely a matter of intention, and an acceptance can be inferred from acts of the landlord inconsistent with the continuance of the lease. *Hand Cut Steaks Acquisition, Inc. v. Lone Star Steakhouse & Saloon of Neb.*, Inc., 289 Neb. 705, 715-16 (2018). The relevant evidence of the landlord's intent is its conduct after the tenant has surrendered the premises. *Id.* at 716. To a lesser extent, the landlord's conduct before the surrender may also be relevant to show its intent. Id. Where a landlord's actions are not inconsistent with an intent to mitigate damages, a court will not presume that the landlord intended to accept the tenant's surrender and terminate the lease. *Id.* at 717.

Typically, a landlord has a duty to mitigate damages when a tenant abandons a premises prior to the expiration of a lease. *Id.* at 718. Until there is abandonment or tender of the property, the owner has no duty to mitigate its damages. *Id.* A landlord may satisfy its duty to mitigate damages by retaking the premises and making reasonable efforts to relet the premises on the tenant's account, to sell the property, or both. *Id.* at 716. Generally, a landlord may recover unpaid rent and expenses due under the lease from the time of the tenant's breach through the time the sale of the property is completed, plus any commercially reasonable expenses incurred in order to procure a new tenant or buyer. *Id.* at 719. The landlord's efforts must be commercially reasonable under the circumstances. *Id.*

Overall, it took 10 months from the tenant's surrender of the property until the sale was complete. The rent that accumulated during that period was approximately $90,000. *Id.* at 720. The Court concluded that the landlord's efforts to lease or sell the property were reasonable, but that the delay after the execution of the letter of intent was not reasonable. *Id.* This conclusion was found based on the facts presented—i.e., the landlord knew that the new buyer was "notorious" for delays and thus the delays were attributable to the landlord's choice to pursue a deal with that specific buyer. *Id.* Nevertheless, since the landlord's efforts to mitigate were reasonable up to a certain point, the Court affirmed the district court's award of damages for unpaid rent. *Id.* at 721. Additionally, the Court affirmed the district court's award of damages based on amounts due under the lease for common area maintenance, utilities, repairs, and maintenance, taxes, and insurance. *Id.*

Elderberry of Weber City, Ltd. Liab. Co. v. Living Ctrs.-Southeast, Inc., 794 F.3d 406 (4th Cir. 2015)

In this case, Elderberry of Weber City leased a facility to Living Centers in November 2000 for a 10-year lease term. However, in 2006, the lease was amended to allow Living Centers to assign the lease to FMSC or any of its subsidiaries or affiliates without prior approval from Elderberry so long as Living Centers first obtained a guaranty. In accordance with the amendment, the lease reset for a new 10-year term commencing at the completion of certain construction and improvements to the facility, and thus a new lease expiration date was set for April 2017. In 2007, Living Centers assigned the lease to FMSC and, in turn, FMSC assigned the lease to Continium in November 2011. In the midst of these assignments, the facility had numerous problems, including being listed as a "Special Focus Facility." Continium ceased making rent payments after March 2012. Although Elderberry and Continium thereafter attempted to negotiate rent reductions, Continium indicated in May 2012 that it was no longer able to make rent

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payments. On August 24, 2012, Elderberry mailed the appellants a letter bearing the subject line, "LEASE TERMINATION NOTICE." The letter stated: "this letter shall serve as notice that the Lease is hereby terminated, effective 12:00 midnight EST on August 24, 2012. [Elderberry] reserves all rights and remedies related to Tenant's default whether under the Lease, at law or in equity." Elderberry's attempts to locate a new tenant were initially unsuccessful because of, among other problems, the facility's placement on the Special Focus Facility list. Eventually, Elderberry hired Smith/Packett Med-Com, LLC, to locate a new tenant, conduct lease negotiations, and provide asset management services. Elderberry rehabilitated the nursing facility with Smith/Packett's help and eventually entered into a new lease for a new 10-year term beginning January 1, 2013.

Elderberry filed a breach of lease and breach of contract action against the prior tenants. Elderberry sought damages for accrued and future rent, as well as "costs, fees and expenses incurred by Elderberry to preserve and rehabilitate the property; fees and expenses incurred by Elderberry in hiring [Smith/Packett] . . . to locate a replacement tenant; sums expended by Elderberry to pay utilities, insurance premiums, and real property taxes; and attorney's fees and expenses." After the subsequent bench trial, the district court ruled in favor of Elderberry on all claims and concluded that Elderberry is entitled to damages in the amount of $2,742,029.50, plus pre- and post-judgment interest at the rate of 0.13%. The damages award includes: (1) unpaid rent for the period from April 2012 through August 2012, (2) unpaid rent from the period September 2012 through February 2013, (3) a rent shortfall from March 2013 through April 2017, (4) unpaid taxes, utilities, and insurance premiums for the period from August 2012 through February 2013, (5) maintenance fees paid during that same period, (6) payments for architectural and construction services. . . to bring the Facility up to the fire code standards required by the fire marshal, (7) payments to Nova [for renovations and working capital], (8) [the signing fee to Smith/Packett], and (9) [the value fee to Smith/Packett]. *Elderberry of Weber City, Ltd. Liab. Co. v. Living Ctrs.-Southeast, Inc.*, 794 F.3d 406, 408-12 (4th Cir. 2015).

On appeal, the appellate court ruled that Elderberry lost its right to rent that accrued after it terminated the lease of August 24, 2012; however, Elderberry is entitled to any rent that accrued prior to termination of the lease. *Id.* at 413. Additionally, the Court of Appeals held that Elderberry is entitled to non-rent damages that accrued prior to the termination of the lease and thus the case was remanded to recalculate rent and non-rent damages that accrued prior to August 24, 2012. *Id.*

Additionally, this Circuit previously found in the Supreme Court of Appeals of Virginia that when a tenant abandons leased property during the term, the landlord is permitted, at his option, either (1) to refuse to accept the tenant's surrender and sue for accrued rent, or (2) re-enter the premises and accept the tenant's surrender, thereby terminating the lease and releasing the tenant from further liability on the lease. *Crowder v. Virginian Bank of Commerce*, 103 S.E. 578, 579 (Va. 1920). In other words, when a tenant abandons a lease, a landlord may sue for rent due on the balance of the lease term only if the landlord does not terminate the lease. *Id.* The choice belongs to the landlord. *Id.* ("The landlord [is] under no obligation to resume possession of the premises which [have] been wrongfully abandoned, and ha[s] the right to refuse such possession and to hold the tenant liable under the contract.").

Additionally, a landlord may seek compensation for a tenant's failure to return a leased facility in the required condition. *Vaughan v. Mayo Milling Co.,* 102 S.E. 597, 601 (Va. 1920). When an action for breach of lease covenant is brought after the end of the term, the measure of damages is still held to be such a sum as will put the premises in the condition in which the tenant is bound to leave them. *Id.* This is true even if the repairs have not been made by the landlord. *Id.* at 602. Where a lease contains a provision giving the right of cancellation and the agreement is canceled in pursuance of the right given, such cancellation does not extinguish liabilities that have already accrued under the lease, regardless of

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whether the liability is that of the party who exercised the option to cancel the agreement or is the liability of the party against whom cancellation was made. Such cancellation of the lease does, however, terminate liabilities to accrue in the future. Upon the termination of a lease, a landlord is entitled to recover liabilities accrued up to the point of termination. 49 Am. Jur. 2d Landlord and Tenant § 204.

AnyConnect US LLC v. Place, 636 S.W.3d 556 (Ky. Ct. App. 2021)

In *AnyConnect*, the Court of Appeals of Kentucky evaluated what damages a landlord was entitled to after a tenant failed to pay rent and the tenant vacated. *AnyConnect,* 636 S.W.3d at 559. The court held that the unpaid rent amounts for the remaining two years of the lease were recoverable as they were classified as "liquidated damages." *Id.* at 566. In October 2016, the landlord and tenant had signed a three-year commercial lease for an office space. *Id.* at 559. Thereafter, the tenant failed to pay monthly rent in November and December of 2017. *Id.* After landlord declined to offer tenant a smaller space with cheaper monthly rent, the landlord sent a demand letter to the lessee on December 5, 2017, informing them that they must either pay the past due amount or vacate the premises. *Id.* at 560. The tenant informed their landlord that they would be vacating the office space by December 18, 2017, and did so. *Id.* The landlord continued to demand past due rent payments for each month since November 2017, asserting that tenant had breached the lease and was still liable for the full amount. *Id.* The landlord promptly filed suit on April 18, 2018. *Id.* Following a brief procedural squabble, neither party took further action on the matter until June 9, 2020, when the landlord moved for summary judgment. *Id.* at 561. The court granted summary judgment to the landlord on December 14, 2020, awarding the landlord the full amount of past due rent owed from November 2017 to the end of the lease term in October 2019, plus pre-judgment interest, attorney's fees and costs. *Id.*

On appeal, the court of appeals first found that the tenant's vacation of the premises did not extinguish the tenant's obligation to pay rent for the duration of the term. *Id.* at 562. The tenant argued that the December 5, 2017, demand letter for nonpayment of rent from the landlord constituted a termination of the lease and extinguished its rights to rent during the term. *Id.* The court rejected this argument, finding that the demand letter was not an "eviction notice" but rather merely asserted the rights of the landlord under the lease. *Id.* The tenant failed to cure its breach, and instead decided to forfeit its rights to the property. *Id.* at 563. The court expressly found that the tenant did not abandon the premises nor did the landlord terminate the lease. *Id.* at 562, 563. The court held that because the tenant vacated the premises on December 18, 2017, the tenant breached the lease agreement from November 2017 to October 2019, and the landlord was entitled to damages for the lost rent payments. *Id.* Under the lease agreement, the tenant had agreed to pay monthly rent to the landlord to operate in the rented space. *Id.* at 564. Considering this provision, the court found that the missing rent payments were "liquidated damages" as they were specified amounts that the landlord was entitled to under the lease and would have received if the tenant had not breached. *Id.* Thus, the appellate court affirmed the trial court's award of future rent under the lease. *Id.*

D. Do Shopping Center Lease Use and Prohibitions Need to Modernize?

In a shopping center context, the landlord and tenants often agree to use and restrictive covenants to balance a certain mix of retailers. Tenants often want broad use provisions for their leases and may want to limit the landlord's ability to lease to other retailers of similar use to keep competition out of the center for that tenant. In changing economic times for shopping centers, old-fashioned views of what tenant mix belongs in a center are changing. We have seen the industry change over time with respect to retailer types that were previously frowned upon (*e.g.*, massage service locations, entertainment type experiences, distribution, drop box and warehouse uses, and other non-traditional retail uses).

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Landlords needing to fill centers have had to often find creative uses or tenants for their centers, and tenants, one would think, would welcome some tenants to keep a center thriving and open. But with shopping centers changing their tenant mixes to keep the centers afloat, are the underlying leases and the use/restrictive covenants in the leases keeping up?

Under traditional contract interpretation cases, the language of any use or restrictive covenant will govern a premises' use. For example, in *Western Assets Corp. v. Goodyear Tire & Rubber Co.*, the Seventh Circuit Court of Appeals reversed the district court's judgment that Goodyear could only use its space as a wholesale truck tire center. 759 F.2d 595, 599-600 (7th Cir. 1985). The use provision in the lease provides for Goodyear "to use and occupy the premises for the sale of such products and furnishings of such services as in Goodyear service stores generally, including but not limited to the servicing, storing and repairing of motor vehicles, and the selling to consumers and to others in the servicing of tires, tubes, oil and other lubricants, motor and tire accessories and kindred products, or for any other lawful purposes." *Id.* at 596. The district court found that "Western Assets leased the premises to Goodyear for the specific purpose of operating a wholesale truck tire center . . . and other lawful purposes related to the conduct of such an operation by Goodyear." *Id.* at 599. The Seventh Circuit interpreted "other lawful purpose" more broadly: "Because the lease clause allowed Goodyear to use the warehouse as a wholesale tire center "and for any lawful purpose," we hold that under Illinois law, Goodyear's use of the building was not limited to the operation of a tire center but could also be used "for any lawful purpose." *Id.* at 600. *See also Chicago Title & Trust Co. v. Southland Corp.*, 444 N.E.2d 294, 296-97 (Ill. App. 1982) ("any other purpose" allowed a grocery store tenant to use the premises for any other purpose so long as it is lawful).

The Fourth Circuit Court of Appeals in *Walton v. Wal-Mart Stores* found that Walmart Discount Store did not violate the use provision to maintain a "discount department store" when it changed its operating format to a Bud's Warehouse Outlet because "in the absence of an exclusion of other purposes, a lease for a specific purpose will be regarded as permissive instead of restrictive and does not limit the use of the premises by the lessee to such purposes." And the clause allowed the premises to be used "for any lawful retain purpose." Walton v. Wal-Mart Stores, 1997 U.S. App. LEXIS 5032, at *9 - *10 (4th Cir. 1997).

One older case could not have been more prescient. In a New York lower court, the court found that the tenant butcher store violated the restrictive covenant in its lease when the butcher also sold a small percentage of grocery items even though the overwhelming percentage of its sales were meat items. *See Burber v. Kilamb Prime Meat, Inc.,* 115 Misc. 2d 976, 977, 455 N.Y.S.2d 44, 45 (Civ. Cit. 1982). For the purposes of interpreting the restrictive covenant, the court found that the "tenant's store must be viewed in the light of modern stores of the same character, in the same commercial setting." *Id. at 978, 455* N.Y.S.*2d at 46*. The court continued:

> Such analysis must not be made in a sterile setting, but rather, in the frame of current marketing and trade practices. What is a commonly accepted trading label, or descriptive term for a business or retail store varies with the elements of time, location, operation size, merchandise mix, customer service, promotional display space and other criteria. In other words, the customs of almost every trade are constantly undergoing change. For instance, nearly every modern pharmacist would be out of business if his drugstore operation could not sell other goods and almost every butcher store would be closed if restricted to nothing but the sale of meat.

Id. The court concluded that the sale of "Grocery items" not organically or traditionally related to a butcher's store operation is precluded by the "use" clause of this lease, *Id.* at 979, 455 N.Y.S.2d at 47, and then was left to define a butcher store clause "as a place that sells at retail, meat, poultry and their by-

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products (milk, eggs, butter and lard), including all other items commonly, directly and closely associated with meat and poultry, whether dry, packed, canned or frozen, i.e., seasonings, mustard, ketchup, horseradish, baked beans, sauerkraut, stuffings and coatings," and then added bread, hamburger and frankfurter buns. Id. at 980-891, 455 N.Y.S.2d at 48. The court concluded astutely:

> In an era of ever changing multipurpose retailing operations, labeled as supermarkets, superettes, discount stores, convenience stores, sales warehouses, mini marts, mall operations, variety stores, etc., it would prove beneficial for the drafters of use clauses in leases to be more precise in their draftsmanship so that descriptive marketing concepts will breathe the air of late 20th century economic realities and practice.

115 Misc. 2d at 981, 455 N.Y.S.2d at 48. A modern case worth also reviewing is the Winn-Dixie case in Florida. It struggled to define "staple or fancy groceries" and is a prime example of the struggle of leaving to the courts to define uses and exclusives in shopping center leases. *See Winn-Dixie Stores, Inc. v. Dolgencorp, LLC,* 746 F.3d 1008 (11 Cir. 2014); *Winn-Dixie Stores, Inc. v. Dolgencorp, LLC*, 881 F.3d 835, 843-45 (11th Cir. 2018). In between the two appeals, the district court summarized best the disconnect between lease provisions and courts having to interpret them:

> 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).

Therefore, keeping these traditional notions of contract interpretation in mind, landlords and tenants should review and modernize their use and restrictive covenant clauses to meet the challenges and times of shopping center developments in the 21st century. Otherwise, the landlord or tenant are pinning their hopes on how the Court will interpret older-drafted and outdated provisions.

E. Crypto Rent?

Rent is typically one of the first clauses negotiated in a letter of intent and carries over into a lease with a schedule as well as the CAM provisions. However, not many LOIs or leases address the way in which that agreed upon rent should be paid. For instance, is bitcoin acceptable as "currency" in exchange for the typical dollar that landlords are used to? If not, does your lease say that? What if a tenant decides to pay you in altcoin, bitcoin, or any other type of crypto currency when rent is due? Is that a default which would trigger your remedy clause? In essence, have you addressed what *type* of payment is acceptable as "rent?" Undoubtedly, cryptocurrency is not going away and the SEC has seemingly agreed that bitcoin is not an unauthorized security such that the payment of rent in that form of payment (which can be converted to dollars) is unlawful. Thus, if your lease does not address the type of funds you expect for rent, then smart transactional attorneys should begin to consider whether they need this term in their agreements to ensure that landlords will not need to open a crypto-wallet in order to cash their rent

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checks. While there are currently no published cases where crypto was used to pay rent, recently the Court considered this very issue with respect to the disposition of property. In *Shea v. Best Buy Homes, LLC*, 533 F. Supp. 3d 1321 (N.D. Ga. 2021) - plaintiff listed her house for sale. Best Buy Homes submitted a bid to buy the house and agreed to pay the listing price and provided both financial statements and a web address with a notion "Go to (Web browser address) for more information." Seller accepted the offer without bothering to read or understand the relevance of Best Buy Home's proof of tender. When the parties went to closing, Seller was told she would receive $87k in cash, but then the closing agent asked if she had a crypto wallet as the rest of the sales price would be paid in "*Troptions.*" The seller refused, and after calling several lawyers about what she should do, she refused to close. The prospective Buyer put a *lis* pendens on the house and sued the seller for specific performance, and Plaintiff counter sued for fraud, illegality and mistake. In a case of first impression, the U.S. District Court found that "troptions" were an unregistered security and thus would not be deemed legal consideration; therefore, due to the illegality of the tender, the deal was void on its face. Notably, the result might have been different if bitcoin was used as the SEC seemingly treats bitcoin more as a commodity versus a security.

IV. Implied Covenant: Just When You Thought Your Lease Was Fully Integrated

Parties are often surprised to learn that even with a fully integrated, unambiguous lease, there are implied covenants that govern parties' rights and responsibilities with each other. If that is true, can parties ever truly rely on their lease and avoid entanglements in courts?

Implied covenants are obligations that are deemed to exist, even if not expressly stated. They are terms that are found to be a part of every contract, unless expressly disclaimed by the parties in the lease. The implied covenant is used by courts to help achieve a result that fulfills the court's idea of the reasonable expectations of the parties and to give the contract a spirit it could deem violated even if an action is not purely prohibited.

> Although the express covenant is an obligation explicitly provided for in a written agreement or actually articulated in an oral contract, the implied covenant is not stated in the contract but implied to govern the performance of the parties to act in a reasonable manner. The types and elements of implied covenants that exist vary from state to state but developed over time as the courts and legislatures of the states worked to mitigate the harsh effects of the ancient common law of independent covenants between landlords and tenants. Implied covenants that tend to be more known in the industry are implied covenant of good faith and fair dealing, implied covenant to operate, implied covenant of quiet enjoyment and other implied rights/restrictions. The following examines how these implied covenants have come into play and impacted the outcome of cases with respect to (a) first-class obligations; (b) use of discretionary power and bad faith situations; and (c) requirements to operate.

A. First Class Obligations

1) What Does "First-Class" Really Mean – Courts Don't Know.

Everyone is familiar with the adage, "Landlord must run a first-class shopping center" or tenant must run and operate its store in a "first class condition," but what does that mean? Courts do not seem to know. For instance, if an anchor store pulls out from the center and a data center takes its place, is that still a "first class" shopping center? Alternatively, can landlords prematurely terminate tenant leases in order to revamp the Center under the auspices that it has the right to do so in order to run a first-class center? Can a tenant seek to terminate its lease early if the landlord begins leasing to public entities such

as local libraries and post offices in order to repurpose abandoned space in the center under the guise that doing so would not make the center "first class" any longer? Can tenants who have failed to bargain for a co-tenancy clause in their lease argue the landlord is in default of its obligations to run a first-class center if the tenant believes the occupancy rate of the tenants in the center is unacceptable?

For years, courts have repeatedly grappled with what the term "first class center" means in a lease agreement. In most instances, courts agree that the term "first class center" is ambiguous. *See, e.g., In re Webster Place Ath. Club, LLC,* 605 B.R. 526 (N.D. Ill. 2019) (what is considered a first class mall is ambiguous and subject to expert testimony*); Jo-Ann Stores, Inc. v. Property Operating Co*., LLC, 91 Conn. App. 179 (Conn. App. Ct. 2005) (the term "first class" is ambiguous because there is a reasonable basis for difference of opinion as to what was intended to be included within the term's definition); *Forth-Seventh-Fifth Co. v. Nekalov*, 638 N.Y.S.2d 625 (App. Div. 1996) (a "first class retail store" is ambiguous); *G&J Holdings, LLC v. SM Properties, LP*, 391 S.W.3d 895 (Mo. Ct. App. 2013) (whether common area walkways closed for 36 days violates the practices of a prevailing "first class shopping center" is an issue of fact for the jury to determine). When a term is found to be ambiguous, then the Court opens the door to allow the party to offer evidence of what each party thought the term meant irrespective of the merger clause contained in the lease. See e.g., *Diversified Realty, Inc. v. McElroy*, 703 P.2d 323 (Wash. Ct. App. 1985) (parole evidence was admissible to resolve ambiguity in lease); *Tangren Family Trust v. Tangren*, 154 P.3d 180 (Utah Ct. App. 2006) (parole evidence is not permitted if a lease is fully integrated unless an ambiguity as to the terms of the lease exists).

When ambiguities in the lease exist, fact questions about what the term in dispute means are typically decided by a jury. *See e.g., Mobile Acres, Inc. v. Kurata*, 508 P.2d 889 (Kan. 1973)(summary judgment was improper and could not be decided as a matter of law when an ambiguity in the lease exists and was in dispute); *Madison v. Marlatt*, 619 P.2d 708 (Wyo. 1980) (summary judgment is inappropriate means of construing a contract if it is ambiguous on its face and the extrinsic evidence, admissible as a result of the ambiguity, raises an issue of fact for adjudication); *Etowah Valley Clay Park, LLC. v. Dawson Cty*, 669 S.E.2d 436 (Ga. Ct. App. 2008). Thus, arguments over whether a person is properly operating a "first class store" or "first class shopping center" often mean, unless that term is defined in some definitive way, that there is a good likelihood the parties may go to trial over the dispute and the parties' fate will be put in the hands of a jury.

2) *How Tenants Have Used the "First Class" Term to Seek Relief from the Landlord or Third Parties.*

Most recent published decision arose out of *Jo-Ann Stores v. Sound Props., LLC*, No. C19-1831JLR (W.D. Wash. June 7, 2021). Here, Jo-Ann fabrics store opened in a strip center whereby the landlord agreed in the lease to operate a "first class retail project" and that "the center "shall be used and occupied only for normal retail uses customarily conducted in first-class shopping centers." No further context was given to these phrases. After operating for nine years in the center, a new owner purchased the center. At that time, the center contained a myriad of uses including a bank, a laundry, a cleaning service business, and a dance studio. The new owner asked Jo-Ann stores to execute an estoppel agreement certifying the landlord was not in default; Jo-Ann did so but stated that it "had not inspected the shopping center to…verify the Landlord is in compliance with its obligations". Five years after the new owner had purchased the center, the landlord leased space to a counseling center that helped provide therapy to patients recovering from addiction. Upon learning of the lease, Jo-Ann Stores notified the landlord that it was in breach of the lease because this type of business is not a typical "retail" use found in first class centers. When the landlord continued to allow the counseling center to operate, Jo-Ann stores indicated that it was going to vacate the property (a year earlier than when its term expired) and it sued

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for declaratory relief over whether the counseling center violated the "first class retail" term. In response, landlord argued the "first class retail" term was ambiguous and the fact that the counseling center did not sell anything was not dispositive of the issue. Moreover, the owner pointed out that Jo-Ann Stores did not object to the other non-traditional retail related uses (such as the dance studio) throughout the term of the lease. The Court, however, disagreed and found that the term "retail" was dispositive and given that the counseling center did not sell goods, landlord had breached its contract and Jo-Ann Stores was not estopped by its prior actions in asserting the breach.

Similarly, tenants are attempting to use the "first class center" language as a way to get things from the landlord that they necessarily did not bargain for originally in the lease. For instance, in *Jimbo's Nat. Family Inc. v. Horton Plaza LLC*, No. 37-2018-00025251 -CU-BC-CTL (Cal. Super. July 7, 2021), Jimbo's, a grocer, entered into a lease with Westfield to operate a former Mervyns space that sat vacant for 6 years prior to Jimbo's occupancy. In conjunction with the parties' negotiations, Jimbo's was told the Horton Plaza Center in downtown San Diego would be substantially revamped and improved and that tenants would be vacated in order for substantial improvements to be made to the Center in order to turn it around and make it into a vibrant retail center. None of these representations, however, were made a part of the lease, nor did the lease require the landlord to perform any improvements to the center within any particular time frame. After Jimbo's opened, it began seeing tenants leaving the center and foot traffic dying out. The vacancies caused more homeless to frequent the outdoor center and new tenants did not want to enter the center until it was redeveloped. When articles began appearing alleging the center had become a "ghost town," Jimbo's sued Westfield and argued it was required to run a "first class" outdoor shopping center and by failing to improve it, it breached this obligation. Westfield subsequently sold the center to SCP Horton Owner I-IV and the new owner argued that it was not responsible for Westfield's pre-acquisition conduct and that the lease only required it to operate the common areas in a "first class condition." SCP Horton Owner I-IV argued that because the lease did not impose a "first class" obligation as to the operations of the Center, Jimbo's claims about lack of occupancy, foot traffic, and marketable events should be dismissed as a matter of law. In response, Jimbo's argued that the Lease contained numerous first-class obligations, including (i) the obligations for Jimbo's to run its store in a first-class manner, (ii) the obligation of landlord to repair and upkeep the common areas in first class condition, and (3) the obligation to sublet and assign the lease was conditioned upon any replacement tenant operating the space in a first-class condition. Jimbo's argued these repeated "first class" references impliedly, under the obligation of good faith and fair dealing, meant that the landlord had to operate the entire mall in a first-class manner notwithstanding the fact that Jimbo's knew at the outset of its lease the Mall was in fact dying and it would not be renovated for years into the future. The Court, after considering the arguments of the parties, found that the use of the term "first class" in various provisions of the lease was sufficient enough under the duty of good faith and fair dealing to imply that the landlord was required to run the Center as a "first class" outdoor mall and that Plaintiff's claim that the landlord failed to do so by virtue of the lack of occupancy and foot traffic raised fact questions for the jury to determine. See Order dated November 19, 2021. Thus, even though Jimbo's admittedly knew the center was in transition when it entered into the lease and knew tenants were going to leave the center so that it could be redeveloped, it still was permitted to argue carrying out those actions was a violation of the lease by virtue of hodge-podging together all of the "first class" obligations.

This holding is similar to the *Wallington Plaza, LLC v. Taher,* No. A-4122-09T1, (N.J. Super. Ct. App. Div. July 7, 2011) case where the tenant, a jewelry store, vacated its lease prior to its term due to the condition of the strip center, its parking lot and the vacancies associated with the center. The lease itself only required the tenant to operate its own store in a "quality" "first class reputable" manner. The lease was silent as to the landlord's own obligations over its operation of the center. However, at trial for back rent from the tenant, the tenant showed the condition of the center was in disrepair, the parking lot was

littered with potholes, and that the center was filled with "for rent" signs. At trial, the court found the landlord had an "implied" duty to run a first-class shopping center and keep it in good repair in order to ensure that there was sufficient pedestrian traffic to the center and along with the "deplorable" conditions of the center, the landlord further breached its duty by failing to take steps to relet vacant space within the strip center.

Tenants also have used the "first class" language associated with their own stores in leases to argue they were exempt from the payment of rent due to frustration of purpose during the pandemic. *See, e.g., AGW Sono Partners, LLC. v. Downtown Soho, LLC*, 343 Conn. 309 (2022) (rejecting tenant's argument that the purpose of its lease, to run a first class restaurant and bar, was frustrated by virtue of the state's temporary shutdown order); *The Gap Inc. v. Ponte Gadea New York, LLC*, 524 F. Supp. 3d 224 (S.D.N.Y. 2021) (arguing the purpose of the lease was to run a first class clothing store for which COVID prevented); *Hugo Boss Retail, Inc. v. A/R Retail, LLC,* 71 Misc. 3d 1222 (N.Y. Sup. Ct. 2021); cf., 1877 *Webster Ave., Inc. v. Tremont Center, LLC,* 72 Misc. 3d 284 (N.Y. Sup. Ct. 2021) (tenant stated a claim for declaratory relief by alleging that COVID frustrated the purpose of its lease for which rescission was appropriate when the lease stated the premises shall be used and occupied solely as a first-class night club and no other purpose).

Alternatively, tenants have argued they are not responsible for routine slip and fall cases in the common areas if landlord failed to upkeep them in a "first class manner." For instance, in *Jones v. Earth Fare, Inc.,* a customer was approaching Earth Fare's store and slipped on anti-freeze in the common area parking lot owned by landlord. Customer sued Earth Fare for the injury, and Earth Fare filed a motion to dismiss based upon Landlord's obligation to upkeep the parking lot in "first class" condition and argued it owed no duty to the plaintiff. 2020 WL 1873422 (Tenn. Ct. App. April 15, 2020). The trial court agreed, but on appeal, the judgment was reversed, finding that although landlord agreed to keep the common area parking lot in first class condition, tenant still owed its patrons a duty of care because it had been exercising control over the parking lot when customers would on an ad hoc basis inform it of broken glass or other impediments that they encountered on the way into the store from the parking lot.

Finally, even brokers will get sucked into litigation if they represent to prospective tenants that a project is, or will be, a "first class establishment," but it subsequently does not amount to that. In *Henry S. Miller Co. v. Bynum,* a commercial broker told Bynum, a hairdressing business, that there was a fantastic opportunity in a shopping center that was being built and that by getting in at the ground floor his business would benefit. See 797 S.W.2d 51 (Tex. 1990), *aff'd,* 836 S.W.2d 160 (Tex. 1992). Bynum agreed to lease the space in the center, and the lease provided it would be run in a first-class manner. However, Bynum's business began to suffer, which he blamed on the lack of tenant occupancy, the character of the tenants, utility interruptions due to construction, building materials put in the common areas, the lack of foot traffic, and the construction continuing to take place in and around the Center. As a result of these conditions, the tenant sold his business and sued the broker for the rent he paid to locate and operate within the Center. The court found that the broker had violated Texas' Deceptive Trade Practices Act by virtue of the representations about the Center and was entitled to damages from the broker. 797 S.W.2d 54, 55.

3) *How Landlords Have Used the "First Class" Term to Justify Their Actions at the Center.*

Landlords likewise have attempted to use their obligation to run a "first class center" as a tool to justify making changes to the Center that tenants would not typically agree to under the auspices of having to do so in order to run a "first class" mall. For instance, in the *Lord & Taylor, LLC v. White Flint LP* case, the landlord began to short-lease tenants in order to ultimately demolish the mall and pursue a

mixed-use development in its place. ee *Lord & Taylor, LLC v. White Flint Mall, LP*, 2013 WL 10967496, * 8. (D. Md. Dec. 6, 2013), When Lord & Taylor objected and sought an injunction to stop it, White Flint argued it was entitled to pursue this course of action because the mall had been dying and its obligation to run a "first class center" compelled it to redevelop the entire site. See id., ("there is no realistic way for White Flint to operate the mall successfully without undertaking a major redevelopment." The Court never reached the issue of whether the landlord could rely on this theory because it found the injunction sought to stop the demolition would not be feasible at that point.)

Separate from justifying their own actions tied to how the center is run and/or altered, landlords also use the "first class" language they often insert into a tenant's lease to control the type of build-out and product offerings tenants may have which the landlord feels are inconsistent with the overall concept of the center. For example, in *Mostazafan Foundation of New York v. Rodeo Plaza Associates*, 542 N.Y.S.2d 599 (App. Div. 1989), landlord leased property to a tenant with the following language: "Tenant shall use and occupy demised premises for high fashion department store furnishing high quality clothing, shoes …and any other items of the caliber presently sold in stores such as Bloomingdale's." The tenant subsequently subleased a portion of the space to subtenant who took the lease conditioned upon the terms of the prime lease who intended to rule an electronics store. To gain landlord's consent to the sublease, subtenant agreed to run a "first-class" retail audio and photo equipment store and it would operate its business in accordance with a "Bloomingdale's audio and photographic department." Once the sublease was signed and subtenant began its build-out, landlord inspected the space and complained about the fluorescent lighting and slot wall construction and about the fact that the subtenant wanted to also sell things such as luggage, briefcases and sunglasses. Landlord hired Bloomingdale's "display window expert" who wrote a list of changes that needed to be made in order to meet the standard agreed to in the sublease. Tenant ignored this, and when it opened its store, it did not change any of its fixtures and to add insult to injury, put some erotic ivory figures in the window. The landlord sued for injunctive relief and ultimately prevailed in prohibiting the figurines (which the tenant had removed voluntarily) and the sale of merchandise that was other than audio equipment. The court, however, allowed the fixtures to remain, finding that they could have met the first-class Bloomingdale's standard. *See id.; accord Forty-Seventh-Fifth Co. v. Nektalov*, 638 N.Y.S.2d 625 (App. Div. 1996) (landlord used the "first class" store language in tenant's lease to challenge tenant's practice of hiring people outside the store who were paid to "pull in" customers from the common areas into the store).

4) How to Immunize the "First Class Language"

For landlords and tenants alike, if you want to use the first-class language in your lease to demonstrate what you are expecting, then understand if you fight later about this term, a court will not likely decide the issue and will find it is an ambiguous term. That means that the parties will have to go the distance in the litigation and convince a jury (after spending hundreds of thousands of dollars on what it means). One way to prevent this is to have the parties attempt to define what a "first class center" is by stating for instance that it should be promoted, marketed, upkept in such a way to keep crime rates down and to ensure foot traffic continues to the best of the landlord's ability. In addition, carve out what a "first class" standard does not entail, such as, a certain type of occupancy rate, consent rights over landlord's discretion over tenants, or period construction taking place over the Center and the common areas. This way, the tenant cannot use the vague "first class" center language to seek things it did not bargain for at the outset of the lease (*e.g.,* a co-tenancy clause or fixed site plan). Alternatively, many leases now attempt to insert comparators as an example of the parties' expectations of how a center would be run. Landlords should be careful in using such comparators because that may per se set the landlord up for failure if the comparator centers are of a higher quality than its center or located in a more affluent demographic. Moreover, the comparator center may have plans to improve the center and the financial backing to do it

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which landlord is unaware of but now needs to potentially meet because it agreed it would run its own center in the same first-class manner as that comparator.

However, if the landlord believes it may make changes to the center down the road but it cannot lease the center without agreeing to this "first class" caveat, the vaguer the clause is may benefit the owner so that it can attempt to use the language to later justify changes it may make in the future, including through redevelopments and/or repurposing space.

Further, if a landlord insists upon requiring tenants to agree to run their stores in a first class manner, and inserts other "first class language" that runs to the tenant's own obligations (such as to whom it could sublease to or that certain repairs had to be made in that manner), then this language may work against the landlord should tenant argue that because it was kept to this high standard, then it was implied that landlord would likewise run its center in that same manner.

From a tenant perspective, the lack of any defined "first class" standard in the lease will benefit it as well. For instance, tenant can attempt to rely upon this language for any drop in foot traffic or to assert rights over landlord's tardy construction practices or less than optimal leasing practices even if the lease does not afford tenant with any rights to complain over such issues.

B. Implied Covenant of Good Faith and Fair Dealing

Generally speaking, the implied covenant of good faith and fair dealing is implied by law in every contract for both its performance and its enforcement, unless disclaimed by the parties. *See Frittelli, Inc. v. 350 North Canon Drive, LP*, 202 Cal. App. 4th 35, 135 Cal. Rptr. 3d 761 (2011) ("It is well established that the tenant under a commercial lease may agree to limit the scope of the covenant of quiet enjoyment, whether express or implied as well as the implied covenant of fair dealing.") The covenant is read into contracts to supplement express contractual covenants to prevent a contracting party from engaging in conduct which frustrates or injures the other party's rights to the benefits of the contract. However, there is usually no implied covenant where the lease does not impose such an obligation. Implied covenants are not meant to add duties agreed to by the parties. *See, e.g., Weco Supply Co. v. Sherwin-Williams Company*, 2012 U.S. Dist. LEXIS 110659 (E.D. Cal. 2012) (where the parties entered into a written agreement for the distribution of Sherwin-Williams paint products, the court found that Sherwin-William did not breach the implied covenant of good faith and fair dealing by selling directly to end users outside its retail stores because the agreement specifically allowed Sherwin-Williams to sell directly to end users and there was nothing in the agreement that limited it to retail stores, stating that: "In other words, a claim for breach of the implied covenant of good faith and fair dealing must be based on a specific contractual obligation.")

The covenant also generally requires each party to do everything the contract presupposes the party will do to accomplish the agreement's purposes. This implied covenant is not disclaimed through an integration clause. Some jurisdictions find a breach of the implied covenant of good faith to be an independent and additional cause of action to breach of the contract while others hold that the implied covenant is merely part of the same breach of contract claim.

Of the implied covenants, this is the most commonly used covenant alleged in cases. Some examples of how the implied covenant of good faith and fair dealing have been used:

- **Implied covenant to use discretionary power.** *See Thrifty Payless, Inc. v. The Americana at Brand, LLC*, 218 Cal. App. 4th 120, 160 Cal. Rptr. 3d 71 (2013) (the California Court of Appeals reversed the lower court's demurrer of tenant's claims, including the implied covenant of good faith

and fair dealing, for tenant's increase in the pro rata expenses at the shopping center, stating that: "Merely charging higher rates for these items than estimated during negotiations does not ostensibly breach the express language of the lease. However, Thrifty has alleged Americana has breached [the lease] by improperly exercising its discretion in allocating costs between retail and nonretail space; this conduct as alleged can constitute both a breach of contract and breach of the implied covenant."); *Best Buy Stores, L.P. v. Manteca Lifestyle Center*, 2010 U.S. Dist. LEXIS 47193 (E.D. Cal. 2010) (District Court found in denying motion to dismiss that Best Buy can allege the implied covenant of good faith and fair dealing for failing to build the shopping center as exhibited in the site plan attached to the lease, stating that: "Although the lease does provide defendant with the discretion to construct the Shopping Center 'at various times, and in various phases or sections,' this does not preclude plaintiff from pleading a claim for breach of the implied covenant of good faith and fair dealing.")

- **Bad faith conduct.** Sometimes the court finds the conduct by the landlord or tenant so egregious that equitable relief is afforded a party based on an implied breach of the covenant of good faith and fair dealing. *See Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Associates*, 182 N.J. 210, 864 A.2d 387 (2005) (New Jersey Supreme Court reversed the appellate court affirmance of lower court judgment in favor of landlord for a tenant's purported failure to exercise a purchase option in a lease after the tenant gave timely notice of its intent but failed to make payment believing the payment was not due until closing and landlord never tells tenant of its misunderstanding.) In the court's own words:

> We are not eager to impose a set of morals on the marketplace. Ordinarily, we are content to let experienced commercial parties fend for themselves and do not seek to "introduce intolerable uncertainty into a carefully structured contractual relationship" by balancing equities. But as our good faith and fair dealing jurisprudence reveals, there are ethical norms that apply even to the harsh and sometimes cutthroat world of commercial transactions. Gamesmanship can be taken too far, as in this case. We do not expect a landlord or even an attorney to act as his brother's keeper in a commercial transaction. We do expect, however, that they will act in good faith and deal fairly with an opposing party. Plaintiff's repeated letters and telephone calls to defendant concerning the exercise of the option and the closing of the ninety-nine-year lease obliged defendant to respond, and to respond truthfully. In concluding that defendant violated the covenant, we do not establish a new duty for commercial landlords to act as calendar clerks for their tenants. We do not propose that attorneys must keep watch over and protect their adversaries from the mishaps and missteps that occur routinely in the practice of law. The breach of the covenant of good faith and fair dealing in this case was not a landlord's failure to cure a tenant's lapse. Instead, the breach was a demonstrable course of conduct, a series of evasions and delays, that lulled plaintiff into believing it had exercised the lease option properly. Defendant acted in total disregard of the harm caused to plaintiff, unjustly enriching itself with a windfall increase in rent at plaintiff's expense. In the circumstances of this case, defendant's conduct amounted to a clear breach of the implied covenant of good faith and fair dealing.
>
> We are mindful of the potential pitfalls in enforcing the covenant of good faith and fair dealing. If courts construe the covenant too broadly, it "could become an all-embracing statement of the parties' obligations under contract law, imposing unintended obligations upon parties and destroying the mutual benefits created by legally binding agreements." We have warned that "'an allegation of bad faith or unfair dealing should not be permitted to be advanced in the abstract and absent an improper motive.'" "'Contract law does not require parties to behave altruistically toward each other; it does not proceed on the philosophy that I am my brother's

keeper.'" We stress that while a commercial party does not have to act with benevolence towards an opposing party, it cannot behave inequitably.

- **Implied covenant of exclusivity and implied covenant to refrain from destructive competition.** Courts have grappled with two implied covenants when a tenant believes it was to be the only tenant of that purpose in a shopping center or in close proximity to that shopping center and the landlord subsequently leases to a competitor of the tenant. See Eastern Shore Markets, Inc. v. J.D. Associates Limited Partnership, 213 F.3d 175 (4th Cir. 2000) (the United States Court of Appeals for the Fourth Circuit, applying Maryland law, rejected the notion of an implied covenant of exclusivity, but recognized the potential for a claim based on an alleged breach of the implied covenant to refrain from engaging in destructive competition, finding that "under Maryland law, the intentions of parties as expressed in the lease providing for rent calculated in part as a percentage of sales, combined with the circumstances surrounding the lease's formation, may give rise to an implied covenant to refrain from competition that is destructive to the mutual benefit of the contracting parties."

C. Implied Covenant for Failure to Operate

Covenants relating to the failure to operate come in a number of forms. Some leases expressly require the tenant to continuously operate for certain operating hours or duration, while others even include specific requirements on how it must be open. Operating covenants, when drafted correctly and understood by the courts, have been treated as a top priority. As an Illinois federal district court once stated:

> 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.

Rouse-Randhurst Shopping Center, Inc. v. J.C. Penney Co., 171 F. Supp. 2d 824, 828 (N.D. Ill. 2001).

Some courts, however, have evaluated claims that such terms are implied by other clauses, such as percentage rent clauses, or implied based on other factors. The courts usually disfavor implied covenants. For example, 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, 728-30 (Minn. Ct. App. 1995). The court aptly summarized:

> As a general rule, the law does not favor implied covenants. *Walgreen Ariz. Drug Co. v. Plaza Ctr. Corp.*, 132 Ariz. 512, 647 P.2d 643, 646 (Ariz. Ct. App. 1982); Keystone Square Shopping Ctr. Co. v. Marsh Supermarkets, Inc., 459 N.E.2d 420, 423 (Ind. Ct. App. 1984) (citing Sheets v. Selden, 74 U.S. 416, 19 L. Ed. 166 (1868)). The courts will imply a covenant if necessary to

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effectuate the intent of the parties. But the implication must result from the language employed in the instrument or be indispensable to carrying the intention of the parties into effect." *Closuit v. Mitby*, 238 Minn. 274, 282, 56 N.W.2d 428, 432-33 (1953).

***

The question of whether a commercial lease implies a covenant of continuous operation for a specific use is one of first impression in Minnesota, but numerous cases in other jurisdictions have refused to imply this covenant. They base this approach on the general disfavor for implying terms into a contract that has been negotiated between two parties. Walgreen Ariz. Drug Co., 647 P.2d at 646. 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." *Sampson Inv. v. Jondex Corp.*, 176 Wis. 2d 55, 499 N.W.2d 177, 181 (Wis. 1993).

Factors courts look at that weigh against an implied covenant for continuous operation include: (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; and (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.

Here are some cases where courts refused to imply a covenant to continuously operate: In *Oakwood Vill. LLC v. Albertsons, Inc.*, (Utah 2004), where a tenant decided to "go dark," but continued to pay rent and the lease lacked certain provisions indicating an obligation to operate, the court refused to find that there was an implied covenant to continuously operate.

In the case, Plaintiff landlord and Defendant tenant entered into a lease containing an exclusive agreement that prevented Landlord from leasing space in the shopping center to other supermarket tenants. The lease also provided that the parties would work together to develop the center "as an integrated retail sales complex for the mutual benefit of all real property in the Shopping Center." After 21 years of operating in landlord's shopping center, Tenant moved to another center to become the anchor tenant there. After it relocated, Tenant "went dark," continuing to pay its ground rent, but keeping the space empty. Landlord filed suit against Tenant for breach of lease and argued that the lease contained an implied covenant of continuous operation that required Tenant to remain open during the entire term of the lease. Landlord sought declaratory relief allowing it to terminate the lease and to reenter, relet the premises and obtain damages. The trial court dismissed the suit and Landlord appealed.

The court found that there was no express or implied covenant of continuous operation and that it would have to look at the language of the lease and the conduct of the parties. The court noted the following which led to its conclusion:

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1. There was no percentage rent provision in the lease. This substantially undermined landlord's position that there was an implied covenant of operation. The absence of the provision from the lease strongly suggested that the parties never intended the lease to bind Tenant to operating a grocery store continuously at the shopping center. *Id.* at 1234.

2. There was no "use of premises" provision in the lease that supported Landlord's argument that Tenant had a duty to generate consumer traffic in the shopping center by operating their supermarket store. *Id.*

3. The provision in the lease allowing Tenant to sublet or assign the lease without consent and no restriction on the type of sublessees or assignees, undermines Landlord's claim that Tenant was supposed to operate on the premises for the entirety of the lease term.

4. The provision in the lease permitting Tenant to own and install "in the Leased Premises such fixtures and equipment as it deems desirable" and to remove "Tenant's personal property from the Leased Premises at any time," a provision commonly seen in combination with a right to sublet or assign the lease, is not consistent with a duty of continuous operation. *Id.* at 1235.

5. The lack of any provision allowing Landlord to reenter and re-let the premises in the event that Tenant vacates weighs against a finding of an implied covenant of continuous operation.

6. The lease did not impose a legal duty on Tenant to erect any structure on the premises and that, having constructed a building, Tenant is under no legal obligation to occupy the building. The court explained that the lease stated: "[i]n the event any building on the Leased Premises is damaged or destroyed by a casualty, Tenant shall either repair or restore the building, or remove the rubble and leave the ground in a sightly condition" *Id.* at 1235. This suggests that the parties contemplated a scenario that Tenant would pay rent on bare ground. Drafters should include provisions in their contracts compelling construction and reconstruction in the event of destruction and specifying the time frame for completing such activities.

In *Piggly Wiggly S. v. Heard,* 261 Ga. 503 (1991), the court found that an obligation to pay percentage rent will not automatically create an implied covenant to continuously operate. Plaintiff landlord and tenant supermarket entered into a lease agreement in 1963. As part of the lease, Tenant would pay an annual base rent, as well as a percentage rent of the annual gross sales exceeding $2,000,000. The lease was renewed on the same terms for an additional seven years in 1979, with options to renew for two additional three-year terms. Tenant was acquired by a new corporation. In the second term, Tenant vacated the premises and moved into a nearby shopping center. Tenant continued to pay the base rent, but refused to sublease the vacant store, even though there were interested parties. Landlord sued for breach of lease. The trial and appellate courts found for Landlord and held that the lease contained an express continued use covenant and an implied covenant of continued operation.

The Georgia Supreme Court, however, reversed the lower court's ruling. The court concluded that the lease did not contain an express or implied covenant of continuous operation. The court found that the lease's provision for free assignability by tenant without landlord's consent weighs strongly against construction of the contract which would require Tenant to continuously operate its business. Also, the existence of a substantial minimum base rent, and a provision for percentage rental payments suggests the absence of an implied covenant of continuous operation: "when the rental to be received under a lease is based on a percentage of the gross receipts of the business, with a substantial minimum, there is no

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implied covenant that the lessee will operate its business in the leased premises throughout the term of the lease." (Case citations omitted.)

However, in *Hornwood v. Smith's Food King No. 1,* 105 Nev. 188 (1989), a court may find that there is an implied covenant to operate continuously when an anchor tenant brings in a significant amount of consumer traffic to a shopping center. Plaintiff landlord and tenant supermarket entered into a 30-year lease. The lease contained a provision for a $92,398 minimum annual rent, about 2.7 million dollars in total rent over the 30-year span of the lease. There was also a provision for percentage rent based on sales generated during the previous calendar year. Tenant paid percentage rent for 1979 and 1980 but stopped paying percentage rent due to insufficient sales volume. Tenant closed its business and stopped operating in 1986 without notifying landlord. After closing the store, Tenant continued to pay minimum rent and landlord did not act to evict Tenant immediately. Eventually, Landlord filed suit against Tenant arguing that Tenant breached its lease by ceasing operations and vacating the demised premises before the lease expired. The trial court held that Tenant breached an implied covenant of continuous operation by ceasing operations with approximately 20 years remaining on the 30-year lease. The court found that the shopping center decreased in value over $1 million after Tenant stopped operating, but that the diminution of property value was not foreseeable and compensable. Also, the court held that, because Tenant continued to pay minimum rent, Landlord was not entitled to an award of compensatory damages for breach of lease. The landlord appealed.

The court upheld the trial court's decision that there was an implied covenant of continuous operation. The court noted that the tenant was a sophisticated business entity and that its role as an anchor tenant significantly impacted the landlord's shopping center. Without the tenant, the financial viability of the shopping center is impacted, and this was foreseeable. The court found that the trial court erred in ruling that the diminution in value was unforeseeable and remanded the case for an assessment of the landlord's damages, including attorney's fees and costs.

IV. Boilerplate Provisions Gone Wrong

After negotiating a lengthy deal and lease, it is not uncommon to hear that that the transactional lawyers and the underlying parties did not focus much on or possibly even review the boilerplate provisions that we often find at the end of the agreement. These over-looked provisions often have important implications for the enforcement of a disputed lease provision and, therefore, parties should pay closer attention to these provisions when negotiating and entering into their leases.

This is because "boilerplate in consumer contracts is routinely enforceable—modern commerce depends upon it." *Ryan v. Delbert Servs. Corp.*, 2016 U.S. Dist. LEXIS 121246, at *16 (E.D. Pa. Sept. 8, 2016). "If the fact that a contract is 'lengthy and cumbersome,' contains 'boiler-plate' language, and was signed during a stressful experience is enough to declare a contract unconscionable, then few modern contracts would be enforceable." *Brookdale Senior Living, Inc. v. Walker*, 2016 U.S. Dist. LEXIS 41582, *21 (E.D. Ky. Mar. 29, 2016), *See also Star Leasing Co. v. Indus. Transp., Inc.*, 2010 Ohio Misc. LEXIS 509, *10-*11 (Ct. Com. Pl. July 27, 2010) (determining a detailed, sophisticated master lease executed at arm's length by two businesses was enforceable despite use of boilerplate; stating that "even a contract with boilerplate provisions is still enforceable as long as it is not 'unconscionable' meaning there is 'an absence of meaningful choice on part of one of the parties together with contract terms which are unreasonable favorable to the other party.'")

There are both procedural boilerplate clauses (*e.g.*, construction, notice, dispute resolution, jury waiver, forum, and jurisdiction) and substantive boilerplate clauses (*e.g.,* rent payment, force majeure,

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liquidated damages, entire agreement/integration provisions, and no oral modification) often found embedded in the leases. This article focuses on (a) merger/integration provisions, (b) force majeure, and (c) several provisions affecting damages.

A. Merger/Integration

Entire Agreement. This Lease contains the entire, only, and exclusive agreement between the parties and no oral statements or representations or written matter not contained in this instrument shall have any force or effect. This Lease is the exclusive manifestation of Landlord's and Tenant's mutual intentions and understandings and, to the fullest extent permitted under applicable law, there are no intentions, understandings, or agreements relating to the subject matter hereof that are implied. As a result and consistent with the foregoing, Landlord and Tenant hereby knowingly and intentionally waive, to the fullest extent permitted under applicable law, any and all implied covenants that are not expressly set forth herein, it being their mutual intention that this Lease memorializes all of their understandings, agreements, and intentions. This Lease shall not be amended or modified in any way except by a writing executed by both parties. All of the recitals set forth herein and exhibits attached to this Lease are incorporated into this Lease by reference are for all purposes a part of this Lease.

Parol Evidence Rule. The parol evidence rule—as the name indicates—is an evidentiary rule. It's a filter that controls the evidence a party can introduce at trial to prove an agreement. Generally, the traditional rule bars evidence of prior or contemporaneous oral agreements or promises that contradict or vary an agreement that the parties intended to be complete. If the writing is "fully integrated" then no parol evidence may be admitted to contradict or supplement it. On the other hand, if the writing does not express the entire agreement but is the final record of the matters discussed, then parol evidence may be admitted to supplement the writing. An exception to the parol evidence rule is extrinsic evidence that would successfully demonstrate that an alleged contract is either void or voidable based on misrepresentation and fraud.

Sound Techniques, Inc. v. Hoffman, 50 Mass. App. Ct. 425 (2000)

This case demonstrates that merger clauses are generally unenforceable to protect against claims of fraud or deceit but are enforceable against claims of negligent misrepresentation. In this case, the plaintiff tenant operated a recording studio and leased commercial space from the landlord on a 2nd floor for that purpose. The first floor was operated by a bar that was doing expansion work. Tenant brought suit against the landlord alleging that prior to the execution of the lease, the landlord (through his real estate agent) made false representations concerning the expected noise level from the 1st floor bar. The jury rejected Tenant's claims for breach of contract and deceit but awarded damages for negligent misrepresentation.

The landlord appealed on the grounds that the merger clause in the lease precluded the tenant from recovering damages on account of the leasing agent's negligent misrepresentation, and that the tenant's testimony regarding the landlord's representations as to the noise level was inadmissible under the parol evidence rule. The applicable provision provided:

> "Tenant acknowledges that Tenant was not influenced to enter into this transaction nor has Tenant relied upon any warranties or representations not set forth in this instrument."

On appeal, the appellate court first explained that under *Bates v. Southgate*, 308 Mass. 170, 182-83 (1941), "the settled rule of law is that a contracting party cannot rely upon such a clause as protection

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against claims based upon fraud or deceit." The Court explained that the rule "is an exception to the basic principles concerning the freedom to contract and is grounded upon public policy concerns." *Id.* at 182. However, the Court noted that the case at hand did not concern fraud of deceit; rather, the judgment rested solely upon the jury's finding of negligent misrepresentation.

The Court further explained that courts in other jurisdictions have reached opposite conclusions and "ignore the merger clause to do so, essentially, on the basis that the parol evidence rule applies only to contract claims and has no relevance to a plaintiff's tort action." *Sound Techniques, Inc*., 50 Mass. App. Ct. at 431 (citing *Formento v. Encanto Bus. Park,* 154 Ariz. 495, 499, 744 P.2d 22 (Ct. App. 1987) (one of two grounds for holding); Keller v. A.O. Smith Harvestore Prod., Inc., 819 P.2d 69, 73 (Colo. 1991); *Stamp v. Honest Abe Log Homes, Inc*., 804 S.W.2d 455, 457 (Tenn. Ct. App. 1990)).

The Court declined to follow those holdings because they "fail to acknowledge and take into account the significance of the intent of the misrepresenting party." *Id.* at 432. The Court noted that "[t]o ignore a merger clause and allow recovery for a negligent misrepresentation does little to promote honesty and fair dealing in business relationships." *Id.* In relying on *Bates v. Southgate,* 308 Mass. 170, 184, 31 N.E.2d 551, 559 (1941), the Court explained that "it is intentional misconduct that justifies judicial intrusion upon contractual relationships in order to prevent the wrongdoer from securing contractual benefits for which he had not bargained." *Id.* at 433.

In reversing the jury verdict, the Court explained that the lease was not a contract of adhesion because tenant was represented by counsel during lease negotiations, and there was nothing in the evidence "that shows or even suggests that the integrity of the bargaining process was tainted by illegality, fraud, duress, unconscionability, or any other invaliding clause." Id.

Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am., 341 S.W.3d 323 (Tex. 2011)

This case demonstrates that pure merger clauses, without expressed clear and unequivocal intent to disclaim reliance or waive claims for fraudulent inducement, do not preclude claims for fraudulent inducement. The dispute in this case arose when the owners and operators of a restaurant, Italian Cowboy, terminated their lease because of a persistent sewer gas odor. *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am*., 341 S.W.3d 323, 328 (Tex. 2011).

In a suit against the landlord, the tenants sought to rescind the lease and recover damages for fraud and breach of the implied warranty of suitability. *Id.* During the lease negotiations, the landlord told the tenants that the building was practically new and had no problems. *Id.* The lease contained the following provisions:

(1) that "neither Landlord nor Landlord's agents, employees or contractors have made any representations or promises with respect to the Site, the Shopping Center or this Lease except as expressly set forth herein," and

(2) that "this lease constitutes the entire agreement between the parties hereto with respect to the subject matter hereof." See id.

Upon receiving information that the prior tenant experienced the same problem for which the landlord was aware, the tenants ceased paying rent and closed the restaurant. *Id.*

The tenants then sued the landlord asserting claims for fraud, including both a theory of fraud in the inducement of the lease and fraud based on misrepresentations. They further asserted claims for

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negligent misrepresentation, breach of the implied warranty of suitability, constructive eviction, and sought rescission of the lease. *Id.* at 328. The trial court awarded judgment in favor of the tenants and ordered that the landlord take nothing on its counterclaim for breach of contract. The Court of Appeals reversed and granted judgment in favor of the landlord on its counterclaim for breach of contract. The Supreme Court then reversed the Court of Appeals and rendered judgment in favor of the tenant.

The Court held that the lease provisions did not disclaim reliance on representations made by the landlord and did not negate the reliance element of tenant's fraud claim. The Court explained that "a plain reading of the contract language at issue indicates that the parties' intent was merely to include the substance of a standard merger clause, which does not disclaim reliance." *Id.* at 331. The Court noted that even if the parties had intended to disclaim reliance, "the contract provisions do not do so by clear and unequivocal language." *Id.*

The Court explained that "[a] contract is subject to avoidance on the ground of fraudulent inducement." *Id.* (citing Williams v. Glash, 789 S.W.2d 261, 264 (Tex. 1990); RESTATEMENT (SECOND) OF CONTRACTS § 214 cmt. c (1981) ("What appears to be a complete and binding integrated agreement . . . may be voidable for fraud . . .")). The Court explained that "[f]or more than fifty years, it has been 'the rule that a written contract [even] containing a merger clause can [nevertheless] be avoided for antecedent fraud or fraud in its inducement and that the parol evidence rule does not stand in the way of proof of such fraud." Id. (quoting Dallas Farm Mach. Co. v. Reaves, 307 S.W.2d 233, 239 (Tex. 1957) (citing *Bates v. Southgate,* 308 Mass. 170, 31 N.E.2d 551, 558 (Mass. 1941)).

However, a recognized exception to this rule exists: "[W]hen sophisticated parties represented by counsel disclaim reliance on representations about a specific matter in dispute, such a disclaimer may be binding, conclusively negating the element of reliance in a suit for fraudulent inducement." *Id.* at 332. In other words, "fraudulent inducement is almost always grounds to set aside a contract despite a merger clause, but in certain circumstances, it may be possible for a contract's terms to preclude a claim for fraudulent inducement by a clear and specific disclaimer-of-reliance clause." *Id.* (citing Schlumberger Technology Corp. v. Swanson, 959 S.W.2d 171, 179 (Tex. 1997)).

The Court explained that, here, the only reasonable interpretation of the lease language was "that the parties to this lease intended nothing more than the provisions of a standard merger clause and did not intend to include a disclaimer of reliance on representations." *Id.* at 334. Since the language was clear, the Court did not need to consider any extraneous evidence of the parties' intent to ascertain the true meaning of the contract. Id. The Court concluded that "[p]ure merger clauses, without expressed clear and unequivocal intent to disclaim reliance or waive claims for fraudulent inducement, have never had the effect of precluding claims for fraudulent inducement." *Id.*

The Court emphasized the significant difference between "a party disclaiming its reliance on certain representations, and therefore potentially relinquishing the right to pursue any claim for which reliance is an element, and disclaiming the fact that no other representations were made." *Id.* (Emphasis in original). Here, the lease was the initiation of a business relationship, and "should be all the more clear and unequivocal in effectively disclaiming reliance and precluding a claim for fraudulent inducement." *Id.*

The Court noted that "[n]othing in the language suggests that the parties intended to disclaim reliance." Id. at 336. For example, the "term 'rely' does not appear in any form, either in terms of relying on other party's representations, or in relying solely on one's own judgment," and the generic merger language, as a matter of law, did not disclaim reliance. *Id.* at 336. Therefore, the Court held that Tenant's claim for fraudulent inducement was not defeated.

B. Force Majeure

Most readers are familiar with the litany of cases relying on the force majeure clause during the pandemic to attempt to escape monetary liability under contracts and leases. Overall, these efforts have not been successful. At the outset of the pandemic, the *In re Hitz Rest. Grp.*, 616 B.R. 374 (Bankr. N.D. Ill 2020) case was the first to find that the pandemic altered the contract terms and allowed for Tenant to abate a portion of the rent given it could not use its dining space. A year later, a similar restaurant case led to the same result in Massachusetts. *Unnv 205-207 Newberry, LLC v. Caffe Nero Ams., Inc.*, 2021 Mass Super. LEXIS 12 (Feb. 8, 2021). In each of those cases, the court found that the pandemic relieved the tenant from paying some portion of its rent given it could not operate what the parties intended at the outset of the Lease. *See also, Morgan St. Partners, LLC. v. Chi Climbing Gym Co.,* LLC, 2022 U.S. Dist. LEXIS 35633 (N.D. Ill. Mar. 1, 2022) (Covid qualified as a force majeure event and thus suspended tenant's obligation to pay rent at least for some portion of time to be determined by the court); *In re Cinemex USA Real Estate Holdings, Inc.,* 627 B.R. 693 (Bankr. S.D. Fla. 2021) (theater was not required to pay rent for the time the theater had to close per government orders.)

Since the pandemic occurred, tenants cited the force majeure clauses in leases to excuse their performance and the payment of rent. Most courts, however, have rejected this attempt on the basis that either the lease itself shifted the risk of loss in such situations to the tenant in that it agreed to not offset the rent irrespective of what occurs and/or the provision itself simply did not apply simply because tenant would not be making money in the space as it had anticipated. See, e.g., *55 Oak Street LLC v. RDR Enterprises, Inc.*, 2022 WL 1634229 (Me. June 9, 2022) (finding force majeure clause did not excuse tenant's obligation to pay rent after the governor partially lifted COVID-19 pandemic restrictions where the unambiguous language of the clause contained no indication that it could apply to partially excuse a party's nonperformance over its failure to make a profit due to reduced capacity restrictions and that even as a general matter, economic hardship such as market downturns do not constitute force majeure events unless stated in the contract); *AGW Sono Partners, LLC v. Downtown Soho,* LLC, 343 Conn. 309 (2022) (although lease had no force majeure clause addressing the situation, the doctrine of impossibility would not excuse a restaurant's payment of rent where it was factually possible for tenant to utilize the premises for curbside and take out business irrespective of the large dining room its contracted for and its inability to be used); *Simon Property Group, LP. v. Brighton Collectibles, LLC,* 2021 WL 6058522 (Del. Dec. 21, 2021)(force majeure clause did not allow abatement of rent due to the clause stating that rent would be paid irrespective of any governmental order interfering with performance and that "time" instead would be given in such instances); *1600 Walnut Corp. v. Cole Haan Company Store,* 530 F. Supp. 3d 555 (E.D. Pa. 2021) (holding if a force majeure clause includes the unforeseeable event at issue (such as government restrictions) and the lease requires the payment of rent notwithstanding such restrictions, then the common law doctrines of frustration of purpose, impossibility, impracticability, and failure of consideration are inapplicable defenses and the lease governs the rights of the parties); *CW A&P Mamaroneck LLC v. PFM WC-1, LLC*, 162 N.Y.S.3d 924 (2022) (lease unambiguously required payment of rent in the event of a force majeure event); *Victoria's Secret Stores, LLC v. Herald Square Owner LLC,* 70 Misc. 3d 1206(A) (2021) ("it is of no moment that the specific cause for the government law was not enumerated by the parties because the Lease as drafted is broad and encompasses what happened here- a state law that temporarily caused a closure of the tenant's business. The parties agreed that this would not relieve the tenant's obligation to pay rent."); *In re CEC Entm't, Inc.*, 625 B.R. 344 (Bankr. S.D. Tex. 2020) (CEC's rent obligation was not dismissed under the bankruptcy code under the force majeure clause which carved out its application to its monetary obligations); *55 Oak St. LLC v. RDR Enters.*, 2022 WL 1634229 (Me. June 9, 2022) (while the government orders could qualify as a force majeure event, the orders themselves prohibited the tenant restaurant from being profitable but not from using the space); *Highlands Broadway Opco LLC v. Boss*, 2021 Colo. Dist. LEXIS 895 (Sept. 17, 2021) (tenant who entered

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into a lease after COVID occurred and then tried to use the force majeure clause to abate rent because of COVID was prohibited from doing so because the court found the parties foresaw that government regulations could impact business but the parties executed the lease anyway).

Thus, if another variant of some sort results in more government shutdowns or orders restricting use, it is very likely the force majeure provision will not excuse performance unless it specifically covers this event and allows for rent to be abated in such situations. Moreover, arguably, force majeure clauses are meant to cover events where the event is typically unforeseeable. Government shutdowns and restrictions on use which may occur in the future may likely now be considered foreseeable should they occur again thereby limiting a party's reliance on this provision. Moreover, tenants may be better off in not including a force majeure provision at all knowing that many courts will not consider the common law excuse defenses (frustration of purpose, illegality, impossibility) if such a clause exists in the lease.

C. Damages

1. *Consequential damages, monthly operating, and more*

Most leases typically will have a waiver of consequential damages. Both landlords and tenants usually agree to include provisions in a lease waiving their right to recover consequential, lost profits or punitive damages. In these situations, the prevailing party is only entitled to recover its actual direct damages. Often overlooked, parties should review the waiver of damages provision to know which damages it is waiving because these clauses are routinely enforced. *See, e.g., Westlake Fin. Group v. CDH-Delnor Health Sys.,* 25 N.E.3d 1166, 1178 (Ill. App. Ct. 2015) (enforcing limitation of liability provision excluding indirect lost profits but not direct lost profits). The parties should pay close attention to which damages are waived because some courts will not waive lost profits if not specifically named and will not waive foreseeable direct lost profits. See *DaimlerChrysler Motors Co. v. Manuel*, 362 S.W.3d 160, 183 (Tex. Ct. App. 2012) ("Courts have construed limitation-of-damages clauses to preclude both direct and consequential lost profits where the clauses expressly waived damages for either lost profits or consequential damages, but have held that direct lost profits were not precluded where only 'consequential' damages, either generally or "including" lost profits, were waived.").

Some leases may include a requirement for the tenant to provide monthly operating reports. Landlords will most certainly want these reports if there is a recession, along with more security upfront, before leasing to track the financial viability of the tenant. Interestingly, if the landlord gets these reports, the tenant may be able to argue that the consequential damage waiver is not enforceable because the landlord can see that the tenant was expecting to make a profit. And if the landlord takes some action which then has an impact on the tenant, the tenant can argue that the lost profits waiver is not enforceable because it was foreseeable to the landlord that the tenant would be impacted by virtue of tracking sales. *H.E.D. Inc. v. Konica Minolta Bus. Sols. U.S.A, Inc.,* 2017 U.S. Dist. LEXIS 160370, * 12 (N.D. Ill. Sept. 29, 2017) ("[F]oreseeable damages constitute direct damages, not consequential damages, and it is difficult to imagine how lost profits are not foreseeable when the lessee of a printer is a printing business."); *Englobal U.S. Inc. v. Native Am. Servc. Corp.*, 2017 U.S. Dist. LEXIS 164747, *16 - *17 (S.D. Tex. Oct. 4, 2017) ("Because Native American's lost profits on its contract with Orthios were foreseeable as a 'usual and necessary consequence' of ENGlobal's breach of its subcontract with Native American, the claim for lost profits is appropriately categorized as one for direct rather than consequential damages. The claim is not foreclosed by the mutual waiver provision.").

2. Self-Help Remedies

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(i) Self-Help Remedies for Landlords in Commercial Leases

"Eviction through legal process is undoubtedly the most secure method." *Sol De Ibiza, LLC v. Panjo Realty, Inc.,* 911 N.Y.S.2d 567, 570–71 (N.Y. App. Term 2010). Many leases, however, contain self-help remedies that allow landlords to re-enter the leased premises without resorting to court process upon a tenant's default, termination of the lease or abandoning the premises. This is often problematic, especially for national landlords who have form leases that contain these self-help remedies. Even if a lease contains such remedies, they may be unenforceable under state law no matter what the parties negotiated in the leases. For example:

- There are at least 13 states where there is a common law remedy for self-help not abrogated by statue and often limited to what is agreed to in the lease: Alabama, Alaska, Arizona, Colorado, Hawaii, Kentucky, Maryland, Mississippi, New Jersey, New York, Ohio, Texas and Wisconsin.

  However, even in these states, self-help is discouraged. *See Donegal Assocs., LLC v. Christie-Scott, LLC,* 248 Md. App. 448, 472, 241 A.3d 1011 (2020):

  Based on this case law, a commercial landlord is permitted, although it is not encouraged, to resort to self-help to repossess premises and property within the premises in the following circumstances: (1) the tenant is in breach of a lease; (2) that authorizes the remedy of repossession; and (3) the repossession can be done peacefully.

- There are seven states where self-help is limited to abandonment or other limited circumstances (for example, where are there are certain procedural prerequisites for the exercise of self-help or tenant's right to possession has been terminated): Idaho, Missouri, Montana, Nevada, North Dakota, Virginia and West Virginia.

- There are 20 states and the District of Columbia where the use of self-help is prohibited and commercial landlords are required to only use the judicial process to remove tenants, including Arkansas, California, Connecticut, Delaware, Florida, Georgia, Illinois, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Nebraska, New Mexico, North Carolina, Oklahoma, Pennsylvania, Rhode Island, Tennessee, and Washington. As stated by the Illinois Appellate Court: "[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. Ct. 2006).

- There are 10 states where there are no statutes or reported court decisions that prohibit the use of self-help, including Indiana, Iowa, Kansas, New Hampshire, Oregon, South Carolina, South Dakota, Utah, Vermont, and Wyoming.

Even in states where the self-help remedy is available, the landlord still may not want to 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 Dev., LLC*, a New York trial court found that although New York allows the landlord to use 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. Civ. Ct. Aug. 5, 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

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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 Ct. App. Mar. 15, 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).

(ii) Self-Help Remedies for Tenants in Commercial Leases

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*. For example, the Illinois Appellate Court 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 Assocs., LLC,* 966 N.E.2d 1174, 1198 (Ill. App. Ct. 2012). 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 (App. Div. 2011). On the other hand, some courts have instead adopted the rule of mutually dependent covenants formulated by the 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 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.

However, 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 a 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 Props., LLC v. Burlington Coat Factory of N.H., 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.

So, despite what the lease states and how heavily negotiated the lease may be, 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

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be evaluated strictly. Therefore, in states that allow self-help, often the remedies will be limited to what was agreed to in the lease. The landlords and tenants should be clear as to how those remedies will be enforced. Regardless, 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.

V. What's On The Horizon? Recession? Metaverse Real Estate?

A. Recession Proofing Your Lease

As uncertainty prevails in financial markets, both landlords and tenants need to be thinking ahead also about the types of provisions they will need to stave off litigation and/or cushion any future defaults should we enter into a recession.

From a tenant perspective, ensuring that expenses are capped and that the tenant has flexibility over the space should it financially be compromised down the road ought to be key. Among the clauses to focus upon are capping common area maintenance expenses, having broad audit rights to ensure expenses are charged correctly, flexibility to sublease and assign without overly restrictive landlord consent rights or replacement tenant onerous conditions, shorter terms with more options, go dark provisions, flexible operating covenants, and carving out acceleration provisions or liquidated damage clauses if a default occurs.

Cases arising out of these provisions often occur in times of economic downturn. Consider *Café Gelato v. Simon,* 2021 U.S. Dist. Lexis 97272 (S.D. Fla. May 21, 2021), where tenant filed a class action against Simon and alleged Simon wrongfully imposed utility charges on tenants that did not reflect the actual charges incurred, but instead were the "typical" charges that a utility might charge for the use of electricity for the center. Tenant contends these actions gave Simon a windfall of additional "rent" that it was not entitled to over a 15-year period. Tenant further contends when tenants would complain about the utility charges being excessive compared to other centers, Simon's standard lease form prohibited the tenants from having the right to audit the expense and find out the truth. Tenant also claimed that Simon used a third party to provide false justifications of the utility expenses which were not accurate. Simon has denied these allegations, asserted affirmative defenses, and filed a counterclaim against the tenant for $318,000 contending that throughout the lease, tenant was a "problem tenant" and it violated its continuous operations covenant, failed to run a "first class facility" by putting up "distasteful signage" and subsequently abandoning the premises having never previously complained about the utility charges. The case is set to be tried in Nov. 21, 2022.

From the landlord perspective, in order to weather any recession that may be on the horizon with no idea how long it may last, landlords will undoubtedly be well served if they have: strong due diligence up front on the solvency of the tenant and the ability to ensure the landlord receives monthly or quarterly reports about the sales and volume of business the tenant is doing so that the landlord can track performance and see any issues on the horizon. Landlords also will want to ask for higher security deposits, letters of credit, UCC rights over personally, operating covenants with a specific performance remedy, self-help rights, acceleration clauses, and attorneys' fees for disputes arising under the lease.

Louisville Galleria, LLC v. Kentucky Pub Investments, LLC demonstrates many of these points. 2021 WL 3573016, (Ky. Ct. App. Aug. 13, 2021) In *Louisville Galleria*, tenant was a pub that entered into a lease to operate a pub in a development known as Fourth Street Live. In conjunction with the parties'

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negotiations, Landlord estimated that CAM charges would be approximately $5.00 per square foot of space. Following the LOI being executed, the parties began negotiating the lease and the landlord changed its estimated CAM to be $6.00/sq. ft. Under the lease, the pub was to make estimated payments of CAM to the landlord at that rate, but the CAM charges were not capped, and the pub in addition agreed to pay an amount equal to 20% of an administrative fee. If the CAM charges exceeded the estimated costs, the pub agreed to pay the difference following receipt of a reconciliation notice. Further, the lease indicated that the Galleria could, without notice to the pub, alter its estimate of total CAM expenses. Notably nothing in the lease mandated that Galleria had to present the reconciliation within any time frame. After operating for six years and paying the estimated $6/sq. ft. CAM charge, the landlord sent tenant a series of CAM reconciliations which amounted to CAM being charged at over $17/sq. ft. Tenant refused to pay the excessive prior CAM charges though it continued to pay the rent. The landlord applied the rent to the outdated CAM charges and then defaulted tenant on the rent and filed an unlawful detainer action against it. Tenant lost the unlawful detainer action and attempted to work out a solution where it could stay and operate within the premises, but the landlord did not return its calls right away. As a result, tenant told its staff it would have to close, and it began to move out its belongings. At that time, the landlord stated it never wanted the pub to move out, but instead agreed to let it operate if it would just start paying the CAM at the new rate. The tenant, however, refused to do so. And in response, the landlord seized all of tenant's property and would not allow it to take anything out of the space, including its expensive kitchen equipment. Contemporaneous with these actions, Tenant filed its own suit against Landlord for damages tied to conversion of its property in violation of the lease, for fraudulent inducement by way of grossly miscalculating the CAM changes, and for violating the covenant of good faith and fair dealing by allowing a competitor to move into an adjacent space to the pub. The landlord counterclaimed for the back rent due and owing, the future rent, and liquidated damages of over $1.7m.

After a three-day bench trial, the court found the pub was fraudulently induced by the landlord to enter the lease by virtue of landlord's artificially low estimation of CAM expenses which the court found to be recklessly made without any proper correlation to any estimated expenses of the new project. Because the CAM charges were improperly made, the Court found the tenant should have never been evicted and was entitled to its lost profits ($32k vs. the $1.3m sought). The Court further found that the landlord to be in bad faith for applying the rent to the disputed CAM charges and that the landlord had converted the tenant's property wrongfully. However, the trial court found against the pub on the claim that the landlord had violated the covenant of good faith and fair dealing by virtue of allowing a competitor to operate adjacent to the pub. The Court thereafter dismissed Landlord's counterclaim in its entirety.

The landlord appealed this judgment. In 2021, the Appeals court partially reversed and found that Landlord's CAM estimate at the outset of the lease did not constitute fraud because it was just that --an estimate and/or opinion as to what the future costs may be -- not actually what they are or would be. The Court of Appeals found it did not matter that the landlord really had not done any calculations meant to capture what CAM actually could be in the future based on the new project and that its change from $5 to $6sq. ft. was inconsequential. The court also found it persuasive that the tenant could have asked for back up tied to this estimate prior to entering into the lease but it did not do so making any reliance on this figure unreasonable. In essence, the court found that tenant, by failing to cap CAM agreed to have "unknown exposure." Thus, the eviction of tenant was proper, and landlord was entitled to its future rent. The Court of appeals, however, did find that landlord was not permitted to keep tenant's property and hold it in abeyance. Instead, it was required to sell the property under the UCC and apply the sums to any amounts due and owing. Landlord failed to do this, and the conversion award was upheld.

B. Metaverse Leasing- Are You Ready to Lease a NFT?

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Taking us out of the recession rut, leasing is also taking place in the metaverse. The metaverse is essentially an electronic platform like the Internet that is based on a decentralized concept where buildings can be constructed and people can meet virtually in an electronic based platform. *See "What is the Metaverse, Exactly?",* Eric Ravenscraft, (April 25, 2022) https://www.wired.com/story/what-is-the-metaverse/. Ownership in the metaverse is "essentially absolute, and owners can develop, lease, sell or otherwise use their virtual real estate as they wish, including constructing buildings, operating stores, leasing the property out, or erecting billboards for advertising. *See "Real Estate in the Metaverse: What Is Digital Real Estate? Why Does it Matter"*, the National Law Review, June 17, 2022, Volume XII, Number 186.

There are several types of platforms being developed including Decentraland, Sandbox, Somnium Space, and Cryptovoxels, among others. *See id*. These 4 platforms collectively have over 200,000 digital lots. *See "The Ultimate Guide to Metaverse Virtual Real Estate",* Gerri Mileva, Creator Economy, May 4, 2022. The lots themselves vary in price, but suffice it to say, they have climbed in value. *See id*. Some lots can be bought for $14,000, while a company called Republic Realm spent $913,000 on a parcel in Worldwide Webb Land (a platform). That same company a year later spent $4.23 million on 792 plots in Sandbox. *See "People Are Paying Millions for Land in the Metaverse. Here's Why"*, Daniel Van Boom, CNET, March 24, 2022. One person recently bought a lot next to Snoop Dogg's house for $450,000. See "*PwC, J.P. Morgan, Samsung- buying land in the metaverse*", Kate Birch, Business Chief, February 19, 2022, https://businesschief.com/technology-and-ai/pwc-jp-morgan-samsung-buying-land-in-the-metaverse. Companies are buying digital lots in the metaverse to begin their branding and advertising in a forum they are betting will take off. *See id*. Companies who have already acquired digital lots in the metaverse include Dolce and Gabbana, J.P. Morgan, Miller Lite, Price Waterhouse, Atari, Adidas, Nike, Verizon, HSBC, and Samsung. *See id.; see also "Real Estate in the Metaverse: What Is Digital Real Estate? Why Does it Matter,"* the National Law Review, June 17, 2022, Volume XII, Number 186. Even Barbados became the first sovereign state to develop an embassy in the metaverse (through Decentraland). The first law firm also has opened in the metaverse. *See id*.

Companies are closely watching this because they do not want to be left behind if this concept ultimately takes off and our culture takes an even deeper dive into an electronic reality where your avatar can enter into stores in the metaverse and with PayPal type technology, go into a store, look at the goods shown electronically and purchase it, all with the push of a button or your registration into that platform. It is estimated that the metaverse will be worth $5 trillion by 2030. And consumer spending in that space is estimated to be at $2 trillion in the next eight years. See Metaverse could be worth $5 trillion by 2030, McKinsey report, Tom Mitchelhill, June 16, 2022, Cointelegraph, https://cointelegraph.com/news/metaverse-could-be-worth-5-trillion-by-2030-mckinsey-report. The metaverse will be the next iteration of social media where people can see concerts, go to carnivals, get invited to exclusive parties, and shop such that the goods you buy can either be for your avatar or for your own physical home. See "Investors are paying millions for virtual land in the metaverse", Chris DiLell and Andrea Day, Tech Drivers in CNBC, January 12, 2022. Even Accenture has begun onboarding all of its new employees in the metaverse. *See "Accenture designed its own metaverse for employees, complete with exact replicas of offices"*, Megan Leonhardt, Fortune, April 11, 2022.

To that end, Fashion Street, and other retail type developments, including a Snoop Dogg's community, are cropping up within these platforms where digital real estate is being bought. See "The Ultimate Guide to Metaverse Virtual Real Estate", Gerri Mileva, Creator Economy, May 4, 2022. For instance, Decentraland has 39 current "districts" where real estate lots can be purchased. *See id*. There is a gambling district, a university district, and the fashion district where you can buy lots. *See id*. The real estate (which is in the form of a non-fungible token) can be purchased according to the provisions of that

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platform (such as terms of service or end user license agreements). There are no property taxes, no closing costs, or title searches necessary. There is a digital log of ownership through block chain. Mortgages can also be taken on digital real estate and the UCC is in the process of amending article 9 to cover digital assets called "controllable electronic records" so that they can serve as a security interest. These amendments have not yet been adopted.

In terms of litigation, it's coming, but it is not front and center yet. There are three published cases that use the term "metaverse" and none involve real estate. The terms of service typically govern the digital lot transaction and the platforms are requiring purchasers to agree to arbitration clauses and/or jurisdiction for any dispute in Hong Kong. These terms of service are "subject to change" and will certainly lead to issues if purchasers are not diligent in reading updated terms of service notifications. *See e.g.,* "Your Ownership of Metaverse land is not legal under Property Law: Here's Why", Rahul, Industry Wired, April 29, 2022. Purchasing digital lots will undoubtedly lead to consumer litigation where plaintiff lawyers will argue mutual mistake, fraud or other consumer protection act claims for the purchaser who did not know what they were getting themselves into when they purchased their NFT. Further, while your purchase of a digital lot may be recorded on the blockchain, the platform often controls the way your meta digital lot is constructed (through code) and that will be subject to change and likely litigation with it. Further, what happens if you buy a digital lot in a platform that you believe will take off and it tanks, can you sue to owner for that? Or what if the digital lot you buy is on Fashion Street and you're a retailer, but then the digital lot next to you is bought by a guy sitting in his basement? Does the value of your digital lot just sink and is there a means to recover from the platform if that occurs? All of this will need to be figured out as the technology and the terms for such transactions continue to be developed and refined. *See e.g., "Real Estate Law May Soon Play a Role in the Metaverse,"* March 2, 2022, https://www.sports.legal/2022/03/real-estate-law-may-soon-play-a-role-in-the-metaverse/. In the interim, read the fine print closely with respect to any terms of service and end user agreements and realize that this market is still evolving and doing so quickly so if you want your client to be on the forefront of what's coming, your client may want to lease space in this new social media which is expected to be bigger than the Internet, Instagram and Facebook. In fact, leasing is going on in "TheMall" and the MetaMall. Tenants in the TheMall are Harley Davidson, Nike, Nintendo, and Xbox among others. See "TheMall" to become the largest shopping mall in the Metaverse, Jan Wobbeking, Mixed, May 14, 2022.

Presenters

This was presented by:

- Michelle D. Gambino | +1 703.749.1380 | gambinom@gtlaw.com
- Howard K. Jeruchimowitz | +1 312.476.5037 | jeruchimowitzh@gtlaw.com

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