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"EXCLUSIVE PREDICAMENTS"

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LEASING LAWS

Exclusive Predicaments

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Facing competition in the confines of a shopping centre can be overwhelming without the comfort of a non-competition (often referred to as an exclusive use) clause that restricts the landlord from leasing stores to competitors. These clauses are an important part of many deals, but they can have disastrous results for a landlord that fails to give careful attention to the wording.

Since exclusive-use clauses limit the landlord's ability to lease space, they depress the value of the shopping centre, especially if they fail to include certain basic exceptions. A landlord that breaks a promise not to allow competition risks being sued for damages from lost business by the tenant harmed by the competition, and such a tenant may also be allowed to end its lease and recover its relocation costs, damages from lost business goodwill and other losses caused by being put out of business.

The following are suggestions for ensuring that these clauses, while still giving good protection to the tenant, do not go too far:

Exclude application to existing tenants if their leases do not require them to comply. Existing tenants must be exempted from the restriction if their leases do not allow the landlord to require them to comply with the exclusive. Also, the landlord should reserve the right to enter into new leases with existing tenants or to replace them with tenants that operate similar uses without complying. Otherwise, the landlord may be forced to give up a successful valued tenant or an important part of its merchandise mix when the existing tenant's lease expires.

Protect only the principal business. The tenant's principal business should be described with as much detail as is needed to identify the particular market segment at which the tenant's business is aimed. For example, a retail store primarily selling high-fashion women's evening wear should not be described as a women's clothing store. It is only that principal business, properly described, that should be protected. A tenant should not be allowed to stop other tenants from operating businesses that compete against only an ancillary part of the benefited tenant's business, or to stop other tenants from selling specific items (i.e. shoes or baked goods) as opposed to operating a competing

business (i.e. a women's shoe store or a bakery).

Otherwise, tenants that sell items only on an incidental basis will be unduly restricted. For example, sports stores often sell shoes, and restaurants often sell baked goods.

Exempt anchor tenants. Department stores, supermarkets and other major tenants will not normally agree to be bound by exclusive-use clauses. Failing to exempt anchor tenants can interfere with expansion and redevelopment plans. The result is lost value to the centre.

Exempt certain small tenants. A large tenant such as a 15,000-sq.-ft. sporting goods store should be able to tolerate a small competitor in 1,000 sq. ft., especially if the competitor has different price points and appeals to a different market.

Apply the clause to only a limited part of the centre. A yogurt store on the ground floor of a regional mall shouldn't block another yogurt store at the other end of the mall or on the upper floor.

Time limits. A tenant may need protection only in the first few years of operation while it establishes its business.

Tenant default should suspend the clause. If a tenant is in material default of its lease, the landlord should be free, while the default continues, to lease space and permit tenants to operate under agreements made while the default continues, regardless of the exclusive and regardless of whether the tenant subsequently cures its default.

Discontinuance of business or of sales of protected items should end or suspend the clause. If a tenant benefited by an exclusive shuts its business down or stops selling a protected category of items for a prolonged period, the landlord should be free to lease to competitors of the tenant or allow other tenants to sell items in the protected category.

If a tenant with an exclusive resumes business or resumes selling the protected items, agreements made in the interim must be exempted from the exclusive.

Efforts expended at the clause-negotiation phase to tailor exclusive-use clauses properly will minimize predicaments that hamper leasing and depress shopping-centre marketability, while addressing the legitimate concerns of the tenant.