

**Litigating Exclusive Use Clauses
in Shopping Centers**

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*How Exclusive is “Exclusive”?:
The Litigator’s Perspective*

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I. INTRODUCTION

Shopping centers are unique in that they are made up of an amalgamation of different tenants existing in an almost a symbiotic relationship. “[T]he leasing of space in these centers brings into play considerations in addition to those involved in the usual leasing of commercial property, since the ‘center’ (or ‘mall’) concept denotes a unified complex of stores.”¹ The landlord controls the tenant mix by deciding which tenants to lease space to and by entering into commercial leases containing certain operating covenants to ensure the desired tenant mix so that each store provides value to the center as a whole. “The economic interdependence of the parties to the shopping center enterprise has been a primary factor influencing the types of covenants found in shopping center leases, and the construction given those covenants by the courts.”²

One of the most important operating covenants in a shopping center lease is the “use” clause. Use clauses commonly limit the tenant’s rights in or create obligations for the tenant for a particular leased premises. However, it is also possible that the use clause will prohibit the landlord from leasing other space in the shopping center (or in any shopping center owned by the landlord or its affiliates in a certain area) to a competitor or an otherwise undesirable type business. Finally, some clauses may require a landlord to lease other space in the center to certain uses (e.g., certain big box retailers in shopping malls require complimentary uses near their entrances).³

Litigation involving use clauses can have significant effects on shopping centers and their owners. Disputes can arise between tenants that disrupt the center’s and its tenants’ operations. The landlord’s lease

to one tenant may cause it to breach a use clause in another tenant’s lease and result in the landlord facing potential liability on two fronts. The violation of a use clause by a landlord may result in the termination of a lease by an “anchor” tenant, resulting in the potential loss of a center. Tenants may find entire business plans rendered impossible to execute because of restricted use provisions in leases or even in instruments that originate at the time of development of the center or mall and place controls on all or parts of shopping centers or malls such as Covenants, Conditions, and Restrictions (CCRs); Reciprocal Easement Agreements (REAs); or Operation and Easement Agreements (OEAs).⁴

Claims involving use clauses often involve costly injunction hearings where there is a mini-trial early in the case with limited time for lawyers and parties to prepare (sometimes 14 days or less). Moreover, judges may allow both written discovery and depositions prior to an injunction hearing which will greatly increase the costs and may mean that claims and defenses are missed, lost, or at least impaired because of the rapid and usually incomplete development of facts.

Another common problem with litigating use clauses related to shopping centers or malls is that the parties (often the landlord and tenants) have an ongoing relationship. A dispute over a use clause can escalate into an all out war concerning multiple issues under a lease, allegations of numerous “material” breaches, and fraudulent inducement. Regardless of how they arise, such allegations tend to polarize and entrench the parties making resolution through a business solution more difficult.

Use clauses also often require constant monitoring of business operations to ensure

that there is no waiver of a subsequent claim to enforce or that a claim is not barred by estoppel from a party's conduct. This means property managers must be intimately familiar with the use restrictions originating in the leases or the center's development. Tenants may also be found to have waived or abandoned rights to enforce use clauses against the landlord and/or other tenants. Accordingly, store managers need to be aware of the use clauses and rights that may be conferred on the tenant in order to remain vigilant for violations in the center.

Finally (but in no way does "finally" mean our list is exhaustive) use clause litigation often results in a "life or death" struggle for the business. Small retail companies with low operating margins or limited cash flow must have the ability to freely operate their businesses and to avoid competition from other tenants. Another tenant's violation of a use clause and infringement, even for a little while, may drive down sales and impair cash flow sufficiently to make a small retailer be unable to meet ongoing financial obligations.

Understanding these issues in the due diligence phase, as well as in the negotiation and preparation of the lease, may limit clients' exposure later. Moreover, it would be helpful to transactional lawyers to understand use clause litigation to try to include agreements in the lease that might assist a litigator in enforcing the use clause in a subsequent lawsuit. Finally, in order to better advise their clients, litigators need to understand the business considerations of use clauses, how and why they are included in leases, and how they can be utilized in litigation.

This article will look at some of these issues. The article is not a survey of law in

the various jurisdictions.⁵ The reader will necessarily have to consider the impact of legal precedent in his or her jurisdiction on the issues raised herein. This article will provide a practical guide that identifies issues for the reader to address in his or her individual circumstances.

II. GENERAL NATURE OF USE CLAUSES

Use clauses may be found in various instruments from leases to CCRs to statutes and regulations. An immediate issue that occurs in some jurisdictions is the struggle courts have faced generally (often in the case of use clauses) whether to utilize contract law or real property law to enforce the instrument. Is the use clause an interest in property or a contract right or both? The answer may predict how a court will view each of the issues raised in this article.

An example may be found in what rules a court may use to interpret the use clause. Most jurisdictions enforce contracts according to the intent of the parties as expressed in the agreement, or, if the agreement is ambiguous, as demonstrated by parol evidence and fairly standard rules of construction that, for example, require the agreement to be construed against the drafter. However, another rule may apply with regard to use clauses. For example, in Texas, "[r]estrictive clauses in instruments concerning real estate must be construed strictly, favoring the grantee and against the grantor, and all doubt should be resolved in favor of the free and unrestrictive use of the premises."⁶ A similar rule may apply in your jurisdiction. Many courts will construe the lease against lessor. These rules often originate in public policy arguments (regardless of what the parties to these transactions actually intended) favoring a type of party based on historic bargaining

power of such parties or a policy issue such as the unrestricted use of land. Questions exist whether language that many drafters add to contracts that may either require the agreement to be construed against the drafter or specifically state that it will not, would trump these real estate-minded rules of interpretation.

III. TYPES OF USE CLAUSES

Initially it should be noted that many jurisdictions subscribe to the belief that a use clause must be specific and express, rather than merely a description of the nature of the premises. Accordingly, use clauses should not appear by accident but rather because of a specific request of a party that was negotiated and/or agreed to by the parties to the agreement.

Use clauses may be restrictive or permissive in nature and often have both a permissive and a restrictive element to them. Generally, many courts interpreting use clauses that permit a use or state a specific use will conclude that the use clause is permissive rather than restrictive.

For example, a common use clause states how the tenant may use the premises, e.g. a women's shoe store. The clause may expressly or impliedly limit the use to the one stated. The clause may also give the tenant the exclusive right to that type of use (business) for that shopping center.

A typical use clause reads:

Tenant shall use the leased premises solely for the purpose of conducting the business of *[description of business]* Tenant shall occupy the leased premises for no other purpose and such use and occupancy shall be in compliance with all applicable

laws, ordinances, and governmental regulations. The Tenant agrees to conduct its business continuously in the leased premises for the business above stated.⁷

Generally, a landlord may insert into a lease any restriction on the use of the premises, and the tenant is not permitted to object because it is unreasonable.⁸ Clauses that obligate a tenant not to engage in a particular business or restricts a tenant to use of the premises for one particular business and no other will be enforced.⁹

There are also many types of clauses that could be swept within an expansive definition of a "use" clause. In fact, taken to an extreme, every clause that provides for an obligation of a tenant is a "use" clause. Other types of "use" clauses for shopping centers may include a clause that requires a tenant:

- a. to continuously operate;
- b. to refrain from opening another store within in a certain radius of the center;
- c. to maintain certain hours of operation;
- d. to join a tenants' association;
- e. to contribute to a joint advertising fund;
- f. to participate in special promotions;
- g. to maximize sales.

Some jurisdictions also imply a covenant on the part of the tenant not to use the premises in such a way to cause damage to the premises.¹⁰ Regardless of the particular restriction, if sufficiently expressed within the lease, the clause will likely be enforced by the courts.

IV. LEGAL TREATMENT AND ENFORCEMENT OF USE CLAUSES

To analyze any use clause, it is necessary to begin with the basic rule that a tenant has the right to use the leased premises for any lawful purpose, without any interference from the landlord, so long as such use is not forbidden by any express provision in the lease or by some necessarily implied construction of the lease or other document at issue, or that does not result in waste or destruction of the premises. Since a landlord can restrict the use of the premises as it sees fit (with some very limited exceptions), courts are reluctant to substitute their judgment that some other use would serve the owner's purposes. However, courts also entertain a presumption in favor of the free use of the premises and will not enlarge a restriction but instead will interpret the restriction according to the plain language of the lease.

Of course, it is probably axiomatic that courts will not enforce an illegal contract including a lease that includes illegal terms or is for the purpose of permitting an illegal enterprise. The author seriously doubts that "crack dealers" have leases for their "crack houses" much less a commercial lease with an exclusive for that use. However, not all scenarios are that easily analyzed. In some cases, a legal use may subsequently become an illegal use. Sometimes a tenant may have a legal use but because of a failure to comply with certain regulations is operating illegally. Drafting flexibility or, at least a remedy, into the lease may be helpful especially if the proposed use is heavily regulated or is a brand new endeavor that may not be proper. It is unclear whether a severability clause (e.g, one that states unenforceable clauses may be severed from the agreement so that the agreement can be enforced) would remedy a situation where

the particular use in the exclusive use clause is found to be illegal.

A use clause may also be tied to a claim for breach of the implied warranty of suitability for a particular use, a concept that exists in some jurisdictions. The implied warranty of suitability requires that the premises be free of defects which would prevent the premises from being used for the particular purpose under the lease. The use clause may be the vehicle for determining scope of the warranty and whether there was a breach.

Some jurisdictions may not enforce use clauses that require a tenant to actually continually use the premises, always allowing the tenant the option of going dark or abandoning the premises and answering in damages. Other courts will enforce such lease provisions provided they are express.

The permitted or restricted "use" in a clause is oftentimes expressly or impliedly related to the nature of the business at the time of the lease. For example, a "grocery store" may be defined in specific terms in the lease (i.e. certain number of square footage, certain items for sale, etc.) or by general reference to existing operations of grocery stores in the area or even the tenant's other grocery stores. When drafting these types of clause, it is imperative that the drafter know the client's current business and anticipated changes in that business. If flexibility is required, the lawyer negotiating and drafting the lease will need to take care in the limitations on the use and the comparative references utilized, as well as possibly creating an exception to the use clause that "swallows the rule."

Often an issue arises in use clause litigation that the lease at issue is ambiguous and there must be extrinsic evidence to

determine what the parties meant at the time the lease was executed. However, because commercial leases may be decades in length, there may not be any witness to the original transaction that could testify as to the reason for the language at issue. Courts may look to objective standards at the time of the execution of the lease to determine the parties' intent, such as the generally accepted definition of a "convenience store" or the tenant's other operations at the time. Courts may also look at any inconsistencies in language utilized in a use clause presuming that such language was designed by the parties to have an effect (even when the language was merely an accident or oversight). Courts may look to how the same terms are used in other parts of the contract even when those parts of the contract have nothing to do with operations of the tenant. A drafter may choose to include clauses to assist the court in how to interpret the contract and resolve ambiguity.

If they cannot resolve an ambiguity by reference to the language in the contract, many courts will declare the contract "ambiguous." This may be a significant event for the parties and their litigators. In Texas, it means that the judge will be unable to resolve the matter summarily and the interpretation of the contract will be submitted to a jury or other trier of fact after a full trial. This has two effects. First, the case is much more expensive because testimony becomes relevant, depositions are necessary, and documents and correspondence traded at the time becomes discoverable and admissible at trial. Second, at this point in time, what the parties really intended may very well be altered by the rules of construction available in the jurisdiction (i.e., contract construed against the drafter, clauses earlier in a contract prevail over clauses found later in the contract, a list of items limits the general

term described by the list, etc.) as well as parol evidence which may mean the parties' testimony as to what they meant, expert testimony as to industry standards, and jury perceptions of the parties.

Even with a ruling by the court that the use clause is unambiguous and prohibits the conduct complained of, the party seeking to enforce the use clause may have lost the right to enforce the clause because of its actions or inaction. This can be found under several theories. Waiver is often defined as the intentional relinquishment of a known right.¹¹ An important but not necessarily dispositive consideration would be how long the landlord delayed in taking action. Waiver may be implied by conduct. For example, some courts have held that the acceptance of rent from a tenant in violation of a use clause is a waiver. However, other courts have relaxed the rule where the landlord accepting the rent has stated it is not acquiescing in the use and was negotiating with the tenant regarding the violation. It may be possible for a drafter to include a simple no waiver clause in the lease to eliminate this circumstance or even specifically state that the acceptance of rent does not waive such breaches.

Another defense to enforcement may arise under the theory of estoppel where the party with the right to enforce takes some action or makes some statement inconsistent with that right and it is relied on by the other party.

In addition, the ability to enforce a use clause may be preempted by the enforcing party's prior material breach of a provision of the agreement that contains the right to enforce the use clause.

There are several potential claims for violations of a use clause. Obviously, a non-

breaching party may sue the breaching party for breach of contract for failing to comply with a use clause. However, it may be difficult to prove damages, which in some jurisdictions may be an element of a breach of contract claim. Some drafters of leases remedy this with liquidated damage clauses. Such clauses may or may not be enforceable under applicable state law.

An alternative may exist to sue for specific performance. If the lease was drafted in such a way to clearly provide that the use violation is an event of default and provides a remedy for use violations or at least is a non-monetary default, the claim is fairly straightforward. In some jurisdictions, the landlord may assert a claim for declaratory judgment decreeing that there has been a violation of the use restriction.¹² The landlord may request an injunction restraining the tenant from violating the use and to specifically enforce the lease. While some landlords may wish to take advantage of a use violation and avail themselves of any remedy under the lease allowing the landlords to terminate the lease, others may want to enforce the provision to keep the leases in place in order to control tenant mix.

Here are a few questions to help vet litigation issues concerning the use clause:

- Is there a valid and existing lease or other document containing a use clause?
- Is the use clause permissive or restrictive?
- Is the party to be charged with use restriction bound by it?
- Is the use restriction enforceable?
- What is the scope of the use?
- Has the use restriction been waived?

- What is remedy? Damages or injunction
- What are the practical effects of enforcing the use clause against this person?

Other, more practical issues should also be analyzed:

- Litigation between tenants or tenant and landlord is not good for the shopping center's image or operations;
- Landlord and tenant may be litigating and affecting an ongoing business relationship;
- Landlord's reputation;
- Tenant's reputation;
- Fact issues that may increase litigation costs;
- Is this a status quo or mandatory injunction;
- Can an injunction be monitored and enforced?;
- Has landlord created rights in other tenants? *i.e., third party beneficiaries*;
- Will inaction be a waiver?; and
- Will allowing one tenant to violate its use permit another tenant to sue landlord for breach of the covenant of quiet enjoyment?

These questions and many more should be carefully analyzed by the drafter of a use clause.

V. CONCLUSION

Claims involving use clauses may have profound effects on a shopping center.

Moreover, the relationships and practical issues involved present a number of strategic calls for counsel and their clients trying to enforce or avoid restrictive clauses. Accordingly, counsel for landlords and tenants need to take extra caution in evaluating available legal options and formulating strategies so as to maximize their clients' chances of not only prevailing regarding the claim but maintaining the viability of the shopping center. Often those legal options begin in the careful negotiation and drafting of a lease or other real estate instrument containing a restrictive use covenant. Attorneys who routinely negotiate and draft such clauses must be familiar with their clients' business, the shopping center, and the location of use restrictions governing property in and around the center, and the center's current and future development. As noted above, identifying the issues early that regularly lead to litigation as well as understanding how those issues will be presented during that litigation can mean the difference in a shopping center's profit or loss, and ultimately on the center's viability.

⁸ *Alzo Advertising, Inc. v. Industrial Properties Corp.*, 722 S.W.2d 524 (Tex. App. -- Dallas 1986, writ refused n.r.e.).

⁹ *Neiman-Marcus Co. v. Hexter*, 412 S.W.2d 915 (Tex. Civ. App.--Dallas 1967, writ refused n.r.e.)

¹⁰ *Friemel v. Coker*, 218 S.W. 1105 (Tex. Civ. App. Amarillo 1920, no writ).

¹¹ Courts may apply a property concept to say that the party has abandoned its right.

¹² Use clauses have even been the subject of claims under the antitrust laws. Finally, some types of use violations may result in damage or destruction of the premises giving rise to an independent claim against the tenant for waste.

¹ 2-17A Powell on Real Property § 17A.02

² 2-17A Powell on Real Property § 17A.02

³ This clause is often called a co-tenancy clause.

⁴ It is not uncommon for the developer of a shopping center or mall to create reserve tracts or pad sites that it may sell to third parties. The developer will include use restrictions in the developing documents or as part of the conveyance of the reserve to the third party.

⁵ Certain references may be made herein to Texas law only as examples.

⁶ *Davis v. Huey*, 620 S.W.2d 561, 565 (Tex. 1981); see *Settegast v. Foley Bros. Dry Goods Co.*, 114 Tex. 452, 270 S.W. 1014 (Tex. 1925).

⁷ Modern Real Estate Practice Forms § 86:6.