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COMMERCIAL LEASE NEWSLETTERS

Co-Tenancy Clauses
(Part 2)

In last month's Newsletter, we discussed "going dark" and continuous operations clauses in a Lease.

This month we will address an ancillary clause known as "co-tenancy."

I. Working Definition of Co-Tenancy Clause. Roughly defined, a co-tenancy clause is a clause put into a Lease Agreement which benefits the Commercial Tenant. Specifically, the co-tenancy clause is designed to identify the fact that the Lease obligation of the Tenants may be modified at the Tenant's option, in whole or part, as a result of the other Commercial Tenants at the Shopping Center ceasing operations.

II. Example of Co-Tenancy Clause in Operation. As an example, assume Tenant "A" is a retailer that wants to take occupancy at a specific Shopping Center in close proximity to Tenant "B" (Key Tenant). Tenant "A," based upon its due diligence and research, has determined that Key Tenant's occupancy (and, accordingly, the prospective projected profit margins and projected gross sales of Tenant "A") have been determined by Tenant "A" to be directly correlated to the location and operation of Key Tenants at the Shopping Center.

Further in this example, Tenant "A" has determined that in the event Key Tenant ceases operations, discontinues hours of operations, or in some way is not maintaining its normal course of business, that such actions could negatively impact Tenant "A's" own operation.

This results in Tenant "A" requesting a provision to be contained in its Lease which provisions would either (a) reduce the rent of the Tenant in such circumstances; or (b) allow the Tenant to abate its rental payments during such non-operation of Key Tenant or, alternatively, in fact simply cancel its Lease obligations entirely.

The Commercial Landlord or Commercial Property Manager is alerted to the fact that these co-tenancy clauses could have a serious and negative affect on the Commercial Landlord/Commercial Property Manager because of the “domino effect” of the Lease terminations.

III. Suggested Protections for Landlord if Landlord is Going to be Required to Grant Co-Tenancy Provision. In such case the Landlord should require that should the co-tenancy provision be exercised by Tenant “A” in the above example, the co-tenancy provision should only be exercised in the event that (a) Tenant is in full and complete compliance with the Lease Agreement; (b) Tenant itself is fully open for business, staffed, and conducting its business in accordance with the specific use provision of Tenant “A’s” Lease; and (c) Tenant is otherwise in full compliance with the existing laws, together with any rules or regulations promulgated by the Landlord.

IV. Limitation of the Exercise of the Co-Tenancy Clause. Again, if a Commercial Landlord is faced with the obligation to accept a co-tenancy clause, the Landlord should consider some limitations which would include, but may not be limited to, the following:

- (a) Identify the fact that the Key Tenant’s closure must be permanent rather than simply an abatement in its operations, such as an abatement for repairs, maintenance, renovations, etc. Such temporary abatement should not in any way be grounds for a trigger of the co-tenancy provision;
- (b) Require that the triggering of the co-tenancy clause on the closure of the Key Tenant’s location is verified by an actual reduction in gross sales revenue of Tenant “A.” If in fact the closure of Key Tenant has no negative impact upon the then existing gross revenue sales of the Key Tenant, an argument can be made that, notwithstanding the co-tenancy clause, the closure of the Key Tenant, either permanently or temporarily, has had no economic impact on Tenant “A’s” business and should not be grounds for Tenant “A” getting a reduction in rental or allowing Tenant “A” itself to “go dark” or terminate the Lease; and
- (c) Set a specific period of time for the Key Tenant to be closed before the co-tenancy clause goes into effect to allow for a verification of a negative impact on the closure of Key Tenant. Example: requiring that a review of the books and records and gross sales of Tenant “A” be identified after a six (6) month period after closure of Key Tenant and only then and only if a there is a substantial decrease in Tenant’s gross revenues that is attributable to the closure of Key Tenant, would the co-tenancy clause go into effect.

V. Mitigation of Damages by the Landlord. Another provision that the Landlord could insist be included in a co-tenancy clause is the ability of the Landlord to mitigate the damages as a result of the closure of Key Tenant. An example could be that if a Key Tenant announces a closure, that in such event the six (6) month period will be implemented and during such time the Landlord may have an opportunity to replace Key Tenant with a Substitute Tenant which might itself mitigate the closure of Key Tenant’s facility thereby resulting in no

detrimental effect to Tenant "A's" business and negating the ability of Tenant "A" to exercise his co-tenancy clause.

VI. Limitation of Remedies Against the Landlord. Again, if the Landlord is required to accept the co-tenancy clause, the Landlord may consider accepting such co-tenancy clause but indicate that if the Tenant exercises such co-tenancy clause this election would be the only remedy available to Tenant and there would be no consequential or other damages available to the Tenant as against the Landlord. Tenant "A" (in the example of Key Tenant "going dark") under such circumstances could not seek additional damages against Commercial Landlord as a result of Key Tenant "going dark."

VII. Reciprocal Rights of Landlord to Initiate its Own Exercise of a Co-Tenancy Clause. One other provision that can be added in the event a Landlord is required to accept a co-tenancy clause is to allow the Landlord itself to exercise the co-tenancy clause and terminate the Lease of Tenant "A" in the event of Key Tenant vacating the premises.

By way of example and assuming in our above example that Key Tenant is located adjacent to Tenant "A":

Rather than accept the exercise of a co-tenancy clause from Tenant "A" indicating that Tenant "A" could have a substantial reduction in its rent as a result of Key Tenant "going dark," the Landlord would have the opportunity itself to simply terminate Tenant "A's" entire Lease Agreement. This would allow the Landlord to potentially assemble the space in Key Tenant's location and Tenant "A's" location to make a larger "box" for another Tenant to enable the Commercial Landlord to mitigate its damages or lease the Tenant "A" space to another Tenant who would pay full rent. This reciprocal exercise of co-tenancy provision may give pause to the Commercial Tenant in exercising its own rights under the co-tenancy clause.

VIII. Summary. As an overview, it should be understood that the co-tenancy clause would only come into play when another Tenant (Key Tenant) ceases operation or "goes dark." Such action correspondingly and immediately impacts and affects the Commercial Landlord since the other Commercial Tenant (Tenant "A" in our example above) would then be able to exercise the various options under his co-tenancy clause.

Consider the scenario when Key Tenant either ceases operations or temporarily discontinues operations (whether or not they continue to pay rent or not resulting in the Center "going dark" for that space or spaces), which then immediately results in at least one other Tenant (in our example Tenant "A") having the option to reduce or discontinue rent or potentially terminate the Lease. This can have quite a devastating impact on the Landlord. As such, the Commercial Property Manger is alerted to these co-tenancy clauses and alerted to consider all of the various scenarios and legal ramifications of a Commercial Property Lease co-tenancy clause.

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