THE SIMPLE USE CLAUSE: COMPLEX PROBLEMS CAUSED BY A SIMPLE PROVISION

By: Jack Garson, Esq.

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Every lease has a use clause. Most get little thought or attention. Use clauses permit a tenant to do any number of things. Next question?

But wait a minute. You, the landlord, just signed a lease permitting the tenant to close its doors whenever it wants. You just permitted the tenant to sell products that may violate other tenants use clauses, or at least upset other tenants by cutting into their core product sales. Or, you just allowed the tenant to alter its product mix and dramatically reduce the percentage rent that you will receive. Or, you just allowed the tenant to increase the intensity of its use of your property, potentially raising costs for all of your tenants and limiting your ability to lease other premises.

Clearly, overlooking the simple use clause can lead to complex problems. Most landlords treat the use clause as if it is a common-sense statement that will be universally understood and produce no problems until they have been burned.

Consider this actual situation: A landlord leased a store to a furniture retailer. The retailer sold new furniture. The tenant explained to the landlord that with the tremendous financial pressures that furniture retailers face, the tenant should only pay the landlord a low base rent, plus a percentage of sales above an agreed amount. The agreed amount the breakpoint was based upon the tenant's recent annual sales history. The breakpoint was set at $1 million, based upon the tenant's history of sales in the range of $1 million to $1.5 million per year.

Further, the parties agreed that the tenant would pay percentage rent equal to 8% of sales above the annual breakpoint. So, if the tenant had a good year and achieved sales of $1.5 million, or $500,000 above the breakpoint, the tenant would pay the landlord an additional $40,000 in percentage rent for his good year.

Next and this actually happened the tenant decided to "adjust" his business model and sell used furniture, instead of new furniture. Nothing in the lease prohibited this. The lease merely said the tenant could sell furniture, "furniture for the home and office" to be precise.

The new business model turned out terrifically well for the tenant. Selling used furniture generated less revenue, but much higher profit margins. The tenant's sales dropped to $800,000 per year, but because of the lower inventory costs, the tenant's profits increased dramatically, from less than 15% of total sales to almost 40% of the new revenues from the sale of used furniture. That is, even at the lower sales figures for used furniture, the tenant was making far more profit. To top it off, the tenant's sales no longer exceeded the $1 million percentage rent breakpoint, so the tenant did not have to pay the landlord any percentage rent.

The result was a very good deal for the furniture retailer, but not so good for the landlord because it failed to anticipate the economic ramifications of the tenants simple use clause. With careful consideration, the landlord may have restricted the tenant to the sale of only new furniture.

The failure to require a tenant to conduct its use of the premises continuously can produce similar disastrous consequences for a landlord. In fact, a lease that permits a tenant to use the leased premises for a specified use does not require the tenant to do so.

In another notable case, a neighborhood shopping center lease permitted the tenant to operate a drugstore. The tenant paid a low base rent, but attracted many customers to its pharmacy, thereby enabling the landlord to attract other tenants who paid higher rents for the other stores in the shopping center. During the course of the very long term of a drugstore lease, the drugstore decided to move across the

highway to a free-standing location that provided a drive-through for its pharmacy. The tenant was content to continue paying its very low base rent in the shopping center but moved its operations to the new drive-through freestanding store across the highway.

The original landlord suspected that the drugstore was content to pay the rent so that another pharmacy could not rent the premises vacated by the drugstore. The shopping center and its landlord suffered. Many former shopping center customers started shopping across the highway; the sales of other tenants in the shopping center languished, and numerous vacancies popped up in the shopping center. Nothing in the lease expressly required the drugstore to conduct its use of the premises for any particular time periods.

Ultimately, a crafty lawyer forced the drugstore to terminate its lease and pay a substantial settlement, making the landlord whole and allowing the landlord to re-rent the old drugstore premises.

In other circumstances, the lack of precise use clauses causes rampant disputes with other tenants. Consider the real-life case of the gas station that gave away coffee to attract patrons, much to the chagrin of the coffee cafe that actually tried to sell coffee. Consider the modern "grocery" store that sells flowers, greeting cards, beer, wine and liquor, banking services, automotive supplies, lawn care products, etc. while paying a low rent that is subsidized by the smaller tenants from whom the grocery store poaches sales. Consider the video store that sells adult videos, the rug store that conducts "going out of business" sales on what seems to be a monthly basis and the tenant whose frequent deliveries clog loading docks and temporary parking lanes and whose voluminous cardboard disposals fill the common dumpsters.

Consider the real-life case of the shopping center landlord that leased a store to a post office. The post office parked dozens of delivery trucks in the parking lot and the local government refused to issue any certificates of occupancy for new tenants because the post office consumed so much of the available parking.

The lesson is clear: Use clauses require great foresight and care. In one case, the landlord may need to limit the area of restaurant premises that can be devoted to patron seating because it will affect the amount of parking the landlord must provide for the entire property. In another case, the landlord may need to specify that a tenant may sell gasoline and automotive supplies, instead of saying that the tenant may use the premises for a "gas station," to avoid all of the incidental uses such as the sale of prepared foods and grocery items that the term "gas station" may implicitly permit. In still other cases, you may require one tenant to be open for a certain number of minimum hours to generate activity and sales, and in another case, at the same property, you may limit the hours of another tenant to prevent loitering and reduce security concerns.

Never underestimate the problems and potential risks that the simple use clause can present.

ABOUT JACK GARSON

Jack.garson@offitkurman.com | 240.507.1744

Jack Garson's practice focuses on Real Estate, Construction and Business law. He serves as a legal advisor for numerous local, regional and national companies. In his role as legal counsel, Jack also serves as a strategic advisor and lead negotiator. Further, Jack provides guidance on the structure of complex transactions, the resolution of business disputes, the growth and sale of companies, and the management of issues such as liability and risk reduction, employment practices, and enhancing profitability.

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