

# How Retail Tenants Can Avoid Paying Rent Prematurely

By **Joshua Bernstein and Benjamin Joelson** (April 11, 2024)

A retail tenant that is negotiating a lease for a space located in a shopping center or retail development that remains in the design phase or under construction faces many issues to consider.

One important issue for such a retail tenant to consider is the date for the commencement of the tenant's obligations to pay rent and begin operating.

In many retail leases, a tenant's obligation to begin paying rent and operating commences within a certain number of days of the space being delivered by the landlord to the tenant following the landlord's completion of any work. For example, common lease language might consist of the following:

"Term" means approximately 10 years (plus the period of time between the Commencement Date and the Rent Commencement Date) commencing on the "Commencement Date" which shall mean the date upon which the Premises is delivered to Tenant with Landlord's Work (as defined in Schedule A attached hereto and made a part hereof) complete and otherwise in its current "As-Is" condition.

The "Rent Commencement Date" shall mean the earlier to occur of (i) the date upon which Tenant opens for business in the Premises, or (ii) the date which is 90 days following the Commencement Date.

Tenant shall open its business in the Premises to the public upon the Rent Commencement Date and thereafter will continuously operate its business in the Premises for the Permitted Use and for no other purpose whatsoever.

Under this sample provision, the tenant's obligation to pay rent and to open for business has an outside date that is tied entirely to the date that the premises is delivered to the tenant with the landlord's work completed. This is regardless of the status of the construction of the center overall or the occupancy by other tenants in the center.

In the context of a larger retail development, simply because a tenant's own space is ready or has been delivered does not mean that it makes good business or financial sense for the tenant to actually begin operating.

For example, while the tenant's space may be ready for occupancy, critical aspects of the overall development may continue to be under construction, such as parking areas or landscaping.

Perhaps even more critical is that the premises of other tenants in the development remain under construction, in which case the tenant could be one of very few tenants actually operating in the development.

There can be dire financial consequences from not considering these issues in negotiating a



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lease. A center that appears to the public to remain under construction is not a draw to the consuming public. Similarly, a tenant's sales will be far less in a center where it does not have its co-tenants operating and drawing in customers. These issues are amplified by the fact that construction can be unpredictable.

Therefore, tenants should consider a variety of options to address this situation. For example, a tenant may seek to negotiate a lease whereby it is only obligated to operate and pay rent once a certain percentage of the floor area of the center is open for business.

Even more creative is a scenario in which the tenant may be required to open based on a certain percentage of the floor area of the center being open for business, but the tenant pays only percentage rent or part of the minimum base rent until a higher percentage of the floor area is occupied.

Even then, tenants need to be careful about which types of other tenants are included in the co-tenancy requirement. Does the tenant want to count only those tenants with exterior storefronts at the center? Does the tenant want to include office or coworking tenants in that calculation?

Yet another strategy for a tenant in this situation is to build in a termination right and reimbursement of tenant build-out costs in the event that the co-tenancy requirement is not met by a certain date.

Sample lease language could consist of the following:

If on the Commencement Date, fewer than 50% of the total Floor Area of the Center available for occupancy is occupied by Qualifying Tenants who are open for business (the "Opening Co-Tenancy Requirement"), then Tenant shall nevertheless open for business on the Commencement Date and, subject to the terms of this paragraph, in lieu of Minimum Rental otherwise due and payable Tenant shall be permitted to pay the lesser of (a) 60% of the Minimum Rental due, or (b) 7% of Gross Sales (the Rent due under (a) or (b) shall be referred to as "Alternate Rent").

Tenant shall be permitted to pay Alternate Rent until such time as the Opening Co-Tenancy Requirement is satisfied. In the event the Opening Co-Tenancy Requirement is not satisfied within 3 years of the Commencement Date, Tenant shall, upon written notice to Landlord, have the additional right to terminate the Lease.

For those tenants that have already executed leases without any co-tenancy requirement or termination right, it can be difficult to overcome language in a lease that is clear and unequivocal. Courts will enforce the clear terms of a contract and do not consider it within their province to alter a contract entered into by sophisticated commercial parties.[1]

Indeed, the Court of Appeal of the State of California, Third Appellate District, has specifically observed in *JJD-HOV Elk Grove LLC v. Jo-Ann Stores LLC* in 2022 that "[t]he parties' contractual intent when reduced to writing should be controlling and enforced, particularly as applied to the commercial leasing market in arms-length negotiations and transactions." [2] That can, of course, also work to the benefit of the tenant. [3]

Although every contract has a covenant of good faith and fair dealing, courts routinely hold that the covenant cannot be used to alter the plain terms of a contract. [4]

Commercial frustration of purpose arguments are also difficult to succeed on. If the

language in a lease is clear that the tenant must open and pay rent by a certain date, without any co-tenancy requirement or other conditions, a court is unlikely to imply such a term or excuse the tenant from its obligations.

In *Iodice v. Bradco Cleaners Inc.* in the Massachusetts Appellate Division, Northern District,[5] in 1993, a tenant abandoned its leased premises and argued that it should be excused from its obligations because "the benefit of its bargain in leasing commercial space in the plaintiff's shopping center was destroyed by the unexpected departure of the center's 'anchor' stores and the consequent reduction of consumer traffic and business opportunity in the center." [6]

The tenant's rental obligations in the lease, however, were not conditioned on the continued tenancy by any tenants or upon the business or occupancy level of the shopping center.

The Massachusetts court held that while the continued existence and operation of the shopping center was a basic assumption of the lease, there was no evidence that departure of two of the anchor stores resulted in the effective demise or failure of the shopping center, particularly since two other large tenants remained operating.[7]

The court also held that the tenant's characterization of the purpose of the lease was derived solely from the tenant's subjective assumptions and expectations, which would not constitute implied conditions or binding terms. The court concluded that the tenant assumed the risk of financial default irrespective of cause, and its unconditional rental obligations could not be excused because of a risk that had been allocated to the tenant.

Of course, the goal is to avoid a dispute or litigation, and attempt to negotiate a resolution that is beneficial to both the landlord and the tenant. This may include deferring the payment of rent until a later date when the center is substantially occupied and completed, or adding term onto the end of the lease, among other options.

In sum, lawyers and businesspeople representing retail tenants need to be particularly careful about the terms of leases dealing with the commencement date for the payment of rent and operations in a center that is in the process of being developed.

Retail tenants should ensure that they need only operate and pay rent when the center is substantially occupied, or alternatively that their rental obligations are reduced until an acceptable threshold is met.

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[1] See e.g., *Legum v. Russo*, 133 A.D.3d 638, 639 (N.Y. App. Div. 2015) ("a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms"); *5907 Blvd. LLC v. W. N.Y. Suites, L.L.C.*, A-3709-11T4, 2013 WL 3762695, \*4 (N.J. App. Div. July 19, 2013) ("The court will not make a more sensible contract than the one the parties made for themselves. The parties, especially

sophisticated ones, are generally in the best position to determine their respective needs and obligations in negotiating a contract."); *Gross v. Lasko*, 338 N.J. Super. 476, 485-86 (N.J. App. Div. 2001) ("It is not the function of any court to make a better contract for the parties by supplying terms that have not been agreed upon"); *Morlee Sales Corp. v. Mfrs. Trust Co.*, 9 N.Y.2d 16, 20 (N.Y. 1961) ("The courts may not by construction add or excise terms, nor distort the meaning of those used and thereby 'make a new contract for the parties under the guise of interpreting the writing'").

[2] *JJD-HOV Elk Grove, LLC v. Jo-Ann Stores, LLC*, 80 Cal.App.5th 409, 422 (2022).

[3] *Id.* (enforcing co-tenancy provision that reduced tenant's rent in the event that certain anchor tenants were not open for business or 60% or more of the gross leasable area of the shopping center was not occupied by tenants open for business).

[4] See e.g., *Singh v. City of New York*, 40 N.Y.3d 138, 145 (2023)(observing that "the covenant cannot be used to 'imply obligations inconsistent with other terms of the contractual relationship,' and encompasses only those 'promises which a reasonable person in the position of the promisee would be justified in understanding were included'").

[5] *Iodice v. Bradco Cleaners, Inc.*, 1993 Mass. App. Div. 54 (Mass. App. Div. 1993).

[6] *Id.*, \*1.

[7] *Id.*, \*3.