Caveat Lessor: Courts' Unwillingness to Find Implied Covenants of Continuous Use in Commercial Real Estate Leases

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Rather than operate at a loss when business conditions deteriorate, sometimes a shopping mall tenant chooses to cease operations and continue to pay minimum rent until its lease expires. However, when a tenant ceases operations prematurely, an unhappy landlord often looks to the lease for an explicit or implied covenant of continuous use, in order to evict a defaulting tenant, sue for damages, or seek an injunction for specific performance.

Absent an express provision requiring continuous use, courts are reluctant to impose implied obligations of continuous use. However the mutual dependence of stores in a shopping center may force a court to consider such an alternative. When an anchor tenant ceases operations prior to the expiration of its lease term, mall owners and smaller tenants suffer despite the anchor's continued payment of minimum base rent. An anchor no longer pays percentage rent, a center's reputation in the community declines, fewer patrons are drawn to the shopping center, jobs are lost, and smaller tenants refuse to renew expiring leases.

Whether a court will find an implied covenant of continuous use—and, if so, whether it will enforce it—usually depends on two factors. First, lease provisions requiring a substantial minimum rent without a percentage rent clause generally warrant against finding an implied covenant of continuous use. Conversely, courts have found implied covenants despite the presence of a minimum rent provision, where the minimum rent provision was "insubstantial."[1] Second, if a tenant

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[1] See Carl A. Schuberg, Inc. v. Kroger Co., 317 NW2d 606 (Mich. Ct. App. 1982) (outlining the principle, but determining that minimum rent of $1,474 per month for grocery store tenant was not insubstantial).

retains a right to assign its interest in the lease, an implied covenant of continuous use will not be found.[2]

When courts find an implied covenant, money damages are usually awarded. However, courts have difficulty calculating damages arising from an anchor tenant's termination of operation, since it is virtually impossible to calculate future percentage rents and the effect of non-operation on neighboring tenants.[3] At least one court has issued an injunction forcing an anchor to resume operation despite the court's unwillingness to supervise the shopping center on a long-term basis.[4]

Minimum Base Rent and Percentage Rent

Minimum and percentage rent provisions play a critical role in establishing an implied covenant of continuous use.

Substantial Minimum Base Rent and No Percentage Rent Provision

In *Stop & Shop, Inc. v. Ganem*, the court, ruling on plaintiff's motion for declaratory relief and on the merits, looked to a lease's rent clause to determine whether an implied covenant of continuous use existed.[5] The plaintiff intended to cease operation of its supermarket on the premises and continue to pay the minimum rent and any excess real estate taxes. The defendant lessor threatened suit to compel either the continued operation of a supermarket or an award of damages. The plaintiff contended that the absence of an express continuous use provision together with a greater than nominal rent precluded finding an implied covenant of continuous use. The court, however, felt this too broad a rule, indicating that even "if there is a more than nominal rent, other circumstances such as the fixed rent being slightly below the fair rental value of the property might justify the conclusion that the parties intended that the lessor have the benefit of percentage rent throughout the term."[6]

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[2] Chicago Title & Trust Co. v. Southland Corp., 443 NE2d 294 (Ill. App. Ct. 1982).

[3] Richard R. Powell, Powell on Real Property, § 17A.02[3][b][ii] (1994).

[4] Mass. Mut. Life Ins. Co. v. Associated Dry Goods Corp., 786 F. Supp. 1403 (ND Ind. 1992).

[5] Stop & Shop, Inc. v. Ganem, 347 Mass. 697 (1964).

[6] Id. at 702; see also First Am. Bank & Trust Co. v. Safeway Stores, Inc., 729 P2d 938, 940 (Ariz. Ct. App. 1986) (stating that in agreements where rental is

The court held that the minimum annual rent of $22,000 in a lease that fixes as a base real estate tax figure the 1946 tax of $3,744.90 was substantial. Therefore, it found no implied covenant of continuous use. The court continued, "[a]n apparently substantial minimum rent in an apparently complete written lease, in the absence of a showing of disparity between the fixed rent and the fair rental value, gives ground for the inference that fixed rent and the lessee's self-interest in producing sales were the only assurance of rent that the lessors required."[7]

Substantial Minimum Base Rent and a Percentage Rent Provision

Similarly, when minimum base rent is "substantial" and a percentage rent provision does not result in a significant increase in the amount of rent paid, a court will again not find an implied covenant of continuous use. In *Kroger Co. v. Bonny Corp.*, a shopping center landlord sought to compel a tenant to maintain its supermarket operation.[8] The court held that, among other criteria, "when the rental to be received under a lease is based on a percentage of the gross receipts of the business, with a substantial minimum, there is no implied covenant that the lessee will operate its business in the leased premises throughout the term of the lease."[9] Because the base rent was clearly stated at the beginning of the lease and admitted to be a fair market value return at the time of the lease, the "additional rent" was only a contingency without qualification. The minimum base rent was not significantly below contemplated performance and was therefore "substantial."[10] The Georgia Court of Appeals found no implied duty of continuous use. In dicta, the court distinguished cases that imposed a covenant of continuous use by noting that in such

based either on straight percentage of sales or on minimum fixed rental and additional rental is based on percentage of sales, inadequacy of rent base implies covenant of continuous operation).

[7] Stop & Shop, Inc., 347 Mass. at 702.

[8] Kroger Co. v. Bonny Corp., 216 SE2d 341 (Ga. Ct. App. 1975).

[9] Id. at 344 (quoting 38 ALR2d 1115–1116); see also Walgreen Ariz. Drug Co. v. Plaza Ctr. Corp., 647 P2d 643, 647 (Ariz. Ct. App. 1982) (stating that even in percentage leases, if the maximum fixed monthly rental is adequate to compensate the lessor for the use of the premises, the fact that additional compensation may be forthcoming by way of percentage of sales does not give rise to an implied covenant of continuous occupancy).

[10] Kroger Co., 216 SE2d at 344.

cases, base monthly rents were "insubstantial" in that they amounted to only 50 percent, approximately, of the total rent collected throughout occupancy.

In the context of an implied duty of continuous use, a court must perform a rent analysis to determine what constitutes a "substantial minimum" rent. In general, courts define "substantial rent" as a fair rental value for the premises, and the burden of proving that the agreed base rent is not a fair rental value rests upon the lessor.[11] However, a more pertinent question is whether the minimum rent is an amount the parties would have agreed to, given their mutual understanding that a business would be operated on the premises.[12] In *Kroger*, the lease set base rent at $2,252 per month and calculated percentage rent at 1 percent of Kroger's annual sales in excess of $2,704,000; the court found base rent "substantial" and held that no implied covenant of continuous use existed.[13] Likewise, in *Fifth Ave. Shopping Center, Inc. v. Grand Union Co.*, a Georgia district court could not grant summary judgment for either party where a supermarket lease set base rent at only $866.67 per month, while percentage rent was assessed at 1 percent of revenues over $1,040,000.[14] Despite the low monthly rent and significant percentage rent (amounting to 43 percent of the total rent assessed), the court could not grant summary judgment for the lessor-plaintiff due to the ambiguity of the term "substantial."[15] However, in *Evans v. Grand Union Co.*, the court pointed to the "substantial" base rent rationale of *Kroger*.[16] The lease in *Evans* imposed a monthly base rent of $7,062.71 and assessed additional percentage rent only when annual revenues exceeded $4.5 million.[17] The court found that base rent was "substantial" and held

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[11] See Casa D'Angelo, Inc. v. A&R Realty Co., 553 NE2d 515, 521 (Ind. Ct. App. 1990).

[12] Daniel A. Reicker, "Specific Performance of Shopping Center Leases in California," 21 Hastings LJ 532, 544 (1970).

[13] Kroger Co., 216 SE2d at 342.

[14] Fifth Ave. Shopping Ctr. Inc. v. Grand Union Co., 491 F. Supp. 77, 78 (ND Ga. 1980).

[15] But see First Am. Bank & Trust Co. v. Safeway Stores, Inc., 729 P2d 938, 940 (Ariz. Ct. App. 1986) (finding implied covenant where base rent was not equal to fair rental value of the leased premises. Percentage rent lease clause had to be considered in calculating fair rental value of property and, absent percentage rent, monthly minimum rent was not sufficient to satisfy the obligations that the landlord would incur in financing the construction and development of the property.).

[16] Evans v. Grand Union Co., 759 F. Supp. 818, 824 (MD Ga. 1990).

[17] Id. at 820.

that no implied covenant of continuous use existed, because while the supermarket was in operation, it generated additional rent of only 7.7 percent of total rent.[18] However, by 1990, the Georgia courts stated that although they have never "embraced a specific definition of what is a sufficient percentage rent to necessitate imposition of a duty of continuous use, the cases are clear as to what is not sufficient to establish such duty."[19]

The Anchor Theory

Occasionally, a lessor will argue that an "anchor theory" justifies finding an implied covenant of continuous use. According to this theory, a court could find an implied covenant of continuous use based solely on the economic dependence of the landlord and the satellite stores on the anchor tenant.[20] A seminal case for this proposition is *Ingannamorte v. Kings Super Markets, Inc.*, in which the New Jersey Supreme Court found an implied covenant of continuous use based on a provision in the lease that an anchor store was "to be used and occupied only for a supermarket."[21] The court determined that the

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[18] Id. at 824; Accord Great Atlantic & Pac. Tea Co. v. Lackey, 397 So. 2d 1100 (Miss. 1981) (finding no implied covenant of continuous use "for the purpose of a general merchandise business" inferred from lease that provided for percentage rent in addition to a fixed substantial adequate minimum rent); Carl A. Shuberg, Inc. v. Kroger Co., 317 NW 2d 606 (Mich. Ct. App. 1982) (finding no implied covenant of continuous use in supermarket lease where minimum rent set forth in lease was not insubstantial and no rent was ever realized pursuant to percentage rent clause during first seventeen years of lease).

[19] Evans, 759 F. Supp. at 824.

[20] See Columbia E. Assocs. v. Bi-Lo, Inc., 386 SE2d 259 (SC Ct. App. 1989) (holding that supermarket chain breached rental agreement with shopping center when it ceased operating in center and failed to sublet to another operating supermarket, though it continued to pay rent; major reason shopping center entered into lease was ability of supermarket, as anchor tenant, to draw customers to shopping center); cf. Lilac Variety, Inc. v. Dallas Texas Co., 383 SW2d 193 (Tex. Ct. App. 1964) (finding that where lessee's lease provided that several other stores, including supermarket, were to be opened in shopping mall and that lessee could terminate the lease if supermarket did not remain as tenant due to breach of implied covenant of continuous use, lessee was entitled to cancellation of its lease).

[21] Ingannamorte v. Kings Super Markets, Inc., 260 A2d 841 (NJ 1970). But see GMS Management Co., Inc. v. Pick-n-Pay Supermarkets, Inc., 601 NE2d 72 (Ohio Ct. App. 1991) (holding that provision of commercial lease stating that "tenants shall occupy and use the premises for the operation of a supermarket and related uses . . . and for no other purposes" did not impose on tenant an obligation to continuously occupy and use premises throughout entire term of lease).

The related question of whether a use restriction clause implies a covenant of continuous use frequently arises. There are a host of cases that circumvent the

defendant (tenant's assignee) was aware of the need for a fully operating supermarket and the adverse effect on other stores in the center due to the prior tenant's inadequate use of the predecessor supermarket.[22] However, despite the anchor theory's appeal to lessors, the anchor theory rationale has seldom been followed in subsequent cases.[23]

Right-to-Assign Clauses

Another factor courts consider in an implied covenant of continuous use analysis is whether the lease contains an express right-to-assign clause. In general, the presence of an assignment clause weighs against finding an implied covenant of continuous use. In *Keystone Square Shopping Center Co. v. Marsh Supermarkets, Inc.*, the court held that a lease specifically permitting a tenant to assign or sublease the premises without the landlord's permission—so long as the lease was assigned or sublet to another supermarket operation—did not contain an implied covenant that the tenant would continue to operate a specific supermarket on the leased premises for the term of the lease.[24] In *Keystone*, the lessee, Marsh, moved its supermarket business to a neighboring shopping center after lease renegotiations with

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entire implied continuous use analysis and simply hold that the use of the premises by lessee can be changed so long as any business maintains an operation in the leased premises. See e.g., Bradlees Tidewater, Inc. v. Walnut Hill Inv., Inc., 391 SE2d 304 (Va. 1990); Monmouth Real Estate Inv. Trust v. Manville Foodland, Inc., 482 A2d 186 (NJ Super. Ct. App. Div. 1984); Chicago Title & Trust Co. v. Southland Corp., 443 NE2d 294 (Ill. App. Ct. 1982).

[22] Powell, supra note 3, § 257[3][b][ii].

[23] See Evans, 759 F. Supp. at 818 (holding that anchor tenant's status as commercial tenant was irrelevant in determining whether tenant was under duty of continuous use); Walgreen Ariz. Drug Co. v. Plaza Ctr. Corp., 647 P2d 643 (Ariz. Ct. App. 1982) (holding that inadequate rent and percentage rent provision, which landlord was willing to accept in order to use store as a magnet to draw customers to shopping center and make the center profitable, did not imply covenant of continuous use upon magnet store). But see Mass. Mut. Life Ins. Co. v. Associated Dry Goods Corp., 786 F. Supp. 1403 (ND Ind. 1992) (holding that owner of shopping mall was entitled to injunction requiring anchor store to continue to operate after anchor store announced it intended to close where evidence indicated that the store drew affluent customers to the mall, that specialty shops in the mall would likely suffer if affluent customers ceased shopping at the mall, that owner would then suffer because many of the specialty stores had percentage of sales leases, and more than a third of the mall's leasable area would be vacant if the anchor store closed).

[24] Keystone Square Shopping Ctr. v. Marsh Supermarkets, Inc., 459 NE2d 420 (Ind. Ct. App. 1984); see also Chicago Title & Trust Co., 443 NE2d 294.

landlord, Keystone, failed. Marsh then opened a new lower-quality discount supermarket in the space it originally leased and sought a declaratory judgment in its favor. The court refused to find an implied covenant of continuous use to force Marsh to maintain its original type of supermarket on the premises. It reasoned that since both parties were sophisticated in real estate matters, implying such a covenant would amount to rewriting the parties' agreement.[25] The lease specifically permitted Marsh to assign or sublet the leased premises without the landlord's permission so long as the lease was assigned or sublet to a supermarket operation. The court would not interfere with Marsh's business decision.

In *Kroger*, the presence of an assignment clause also weighed against finding an implied duty of continuous use.[26] Moreover, the landlord's covenant not to place more than one competing grocery store in the mall did not create any covenant on the part of lessee supermarket, Kroger, to use its leased space as a supermarket for the full term of the lease.[27] Kroger wished to cease operations on the premises, continue to pay base rent, and sublease the premises to any type of potential business. In light of the assignment clause, Kroger's use of the premises was not limited to a supermarket business so long as any type of business conducted on the premises was "lawful."[28] Based on *Kroger*, a lessor must ensure that a lease contains an express covenant of continuous use to avoid having a standard assignment clause preclude the lessor from compelling continuous use by a lessee.

However, not every court has held that an assignment clause will preclude finding an implied covenant of continuous use. In *First American Bank & Trust Co. v. Safeway Stores, Inc.*, the court stated,"[t]he presence of a right to assign or sublet is not necessarily inconsistent with an implied covenant of continuous operation. The two covenants can be harmonized to permit subletting or assignment to a business of the same character."[29] However, even in *First Ameri-*

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[25] Keystone Square Shopping Ctr. Co., 459 NE2d at 423.

[26] Kroger Co. v. Bonny Corp., 216 SE2d 341 (Ga. Ct. App. 1975).

[27] Id.

[28] Id.; see also Bradlees Tidewater, Inc. v. Walnut Hill Inv., Inc., 391 SE2d 304, 308 (Va. 1990) (stating that where anchor tenant was assignee of original anchor tenant and lease required assignees to play role of anchor tenant only during first five years of the lease, that period had expired; therefore, tenant could cease operations and any lawful retail business may be conducted).

[29] First Am. Bank & Trust Co. v. Safeway Stores, Inc., 729 P2d 938, 941 (Ariz. Ct. App. 1986).

can Bank & Trust Co., most of the court's analysis in finding an implied covenant focused on an inadequate provision for minimum base rent. Indeed, most courts do not consider the presence of an assignment clause solely determinative of an implied covenant of continuous use. Instead, they examine assignment clauses either to augment a minimum base rent and percentage rent analysis or to provide a rational analysis when the issue of rent does not present itself.

Remedies

With respect to the breach of implied covenants of continuous use, courts have had a fair amount of difficulty formulating remedies. Monetary damages encompassing lost percentage rent are virtually impossible to calculate. Yet courts avoid the alternative remedy of specific performance for fear of becoming long-term supervisors of a shopping center's daily business. In a rare case in which a court did order a lessee to remain in operation, the court issued a preliminary injunction and required that the lessor obtain a bond pending trial on the merits.[30]

When a court refuses to find an implied covenant of continuous use, the lessor is denied damages for a lessee's termination of operation so long as the lessee continues to pay its minimum base rent.[31] If a lessor receives damages, such damages will not include lost percentage rent unless a lessee had an implied duty to generate percentage rent under the lease, notwithstanding any duty of continuous use.[32] Conversely, in the case of *Hornwood v. Smith's Food King No. 1*, the breach of an implied covenant of continuous use caused the court to impose damages upon the lessee (a supermarket) based solely on the diminution in value to the center.[33] In *Hornwood*, the court measured damages as the difference in the shopping center's value with the anchor tenant's lease and the shopping center's value without the lease.[34] The court reasoned that the diminution in value arose natu-

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[30] Mass. Mut. Life Ins. Co. v. Associated Dry Goods Corp., 786 F. Supp. 1403 (N.D. Ind. 1992).

[31] Kroger Co. v. Bonny Corp., 216 SE2d 341, 345 (Ga. Ct. App. 1975).

[32] Casa D'Angelo, Inc. v. A&R Realty Co., 553 NE2d 515, 522 (Ind. Ct. App. 1990).

[33] Hornwood v. Smith's Food King No. 1, 772 P2d 1284 (Nev. 1989).

[34] Id. at 1286–1287; cf. Piggly Wiggly So., Inc. v. Eastgate Assocs. Ltd., 392 SE2d 337, 340 (Ga. Ct. App. 1990) (finding tenant's anticipatory breach of lease did not render tenant liable for loss of percentage rent or damages resulting from loss of other tenants in shopping center).

rally and foreseeably as a result of the lessee's termination of operation and therefore was compensable as a matter of law.[35]

In denying injunctions to enforce express or implied covenants of continuous use, court decisions rest on the availability of economic damages and the difficulty of long-term court supervision of shopping centers. In *8600 Associates, Ltd. v. Wearguard Corp.*, the court refused to issue an injunction forcing continuous operation.[36] The court reasoned that such specific performance was inappropriate because assuming the duty of continuous supervision would unreasonably tax the court's time, attention, and resources.[37] The court also noted in *8600 Associates*, that the lessor retained the right to sublet the retail space, thus mitigating any economic damage. Moreover, courts will deny an injunction based on the failure of a lessor to show irreparable harm were an anchor tenant to close.[38]

On rare occasions, a court will issue an injunction preventing a lessee from breaching an implied covenant of continuous use.[39] In *Massachusetts Mutual Life Ins. Co. v. Associated Drug Goods Corp.*, a U.S. District Court in Indiana issued a preliminary injunction to force the reopening and resumption of an anchor tenant's operation when a mall owner proved that it would suffer irreparable injury were the anchor allowed to close permanently.[40] The May Department Stores Co., parent company of the lessee, planned to cease the lessee's operations because another store that May opened seven and one-half miles away from the lessee directly competed with and sold more

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[35] Hornwood, 772 P2d at 1286.

[36] 8600 Assocs., Ltd. v. Wearguard Corp., 737 F. Supp. 44 (ED Mich. 1990).

[37] Id. at 46; see also New Park Forest Assocs. II v. Rogers Enters., Inc., 552 NE2d 1215 (Ill. App. Ct. 1990) (finding that ten-year mall lease in which lessee contracted not to vacate or abandon premises during lease term was not type of lease court could specifically enforce to prevent lessee from vacating after only fifteen months of occupancy; specific enforcement would involve court in managing shopping center if any problems arose); Madison Plaza, Inc. v. Shapira Corp., 387 NE2d 483 (Ind. Ct. App. 1979) (holding that, despite irreparable harm to lessor, in view of lengthy period of time involved, nature and size of business, and detailed nature of relief sought by shopping center owner, trial court did not abuse discretion when it denied injunction requiring shopping center tenant to continue operating retail store in center pursuant to lease).

[38] See Bradlees Tidewater, Inc. v. Walnut Hill Inv., Inc., 391 SE2d 304, 308 (Va. 1990).

[39] See Dover Shopping Ctr., Inc. v. Cushman's Sons, Inc., 164 A2d 785 (NJ Super. Ct. App. Div. 1960) (However, lessee was a small independent bakery, not an anchor tenant in a shopping center).

[40] Mass. Mut. Life Ins. Co. v. Associated Dry Goods Corp., 786 F. Supp. 1403, 1430 (ND Ind. 1992).

than twice as much merchandise as the lessee.[41] Although the lessee would need to spend approximately $2,750,000 to resume operation, the court found that the lessee's injury did not outweigh the lessor's injury, since the damage to the lessee could be easily measured, the lessee could recoup startup costs in two or three years, and the lessor would be required to post a $1,000,000 bond.[42] The court further reasoned, on the basis of an anchor theory, that although the damages to the lessor-owner were exclusively economic, an injunction forcing the lessee to resume operation should issue for the following reasons: the lessee drew affluent customers to the mall, specialty shops in the mall would suffer if affluent customers ceased shopping at the mall, the owner would suffer because many of the specialty stores had percentage leases, and more than a third of the mall's leasable area would be vacant if the lessee closed.[43] The court was not concerned that an injunction would require its long-term supervision of the shopping center; an injunction would issue because it was more practicable, efficient, and adequate than the relief afforded by law.[44]

The injunction in *Massachusetts Mutual Life Ins. Co.* was issued pursuant to a confidentiality agreement, but according to Alan R. Fridkin, Esq. of the Massachusetts Mutual Life Insurance Company (MassMutual), the "parties lived happily ever after." The lessee reopened its store at the direction of the parent, May. MassMutual invested heavily in improving the mall, thereby increasing the value of its security interest, and the parties outlined mediation measures in the event that any disagreements might arise.[45]

Conclusion

Lessor's counsel should carefully draft an express lease covenant ensuring that the lessee will continually occupy the premises and operate its exact type of business for the duration of the lease. A covenant of continuous use may prevent a lessee from ceasing operations prior to the end of the lease term. However, even with an express covenant of continuous use, a lessor cannot expect a court to

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[41] Id. at 1408.

[42] Id. at 1418–1419.

[43] Id. at 1411–1412.

[44] Id. at 1425–1426.

[45] Telephone interview with Alan R. Fridkin, Esq., Office of the General Counsel, Massachusetts Mutual Life Insurance Co., Springfield, Mass. (Spring 1993).

enforce the specific performance of such a covenant. To avoid uncertain exposure and grant a court some guidance in enforcing a covenant of continuous use, lessor's counsel should also include a provision imposing liquidated damages on the breaching lessee for a sum equal to the percentage rent paid during a specified period, plus an additional amount based on the expected growth of the shopping center and the loss of the lessee's "anchoring" power.[46]

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[46] Reicker, supra note 12, at 547.