

EXCLUSIONARY USES: PROVISIONS IN TRANSITION

Contracts should serve a meaningful purpose and be clearly described.

By Lindsey Postula

When real estate markets ignite and new opportunities arise, Texas property owners have attempted to use antitrust laws to circumvent exclusive use provisions in commercial leases (See, e.g., *City Products Corp. v. Berman*, 610 S.W.2d 446, 448 (Tex. 1980) discussing the exclusive use exception to antitrust laws).

An exclusive use provision constitutes one kind of restrictive covenant that is negotiated between a commercial landlord and tenant. Generally, before the tenant determines that it will invest substantial time and money building its business at the landlord's

location, it requests that a retail landlord ensure that other tenants and users of the landlord's property do not use their leased premises to do business that competes with the business of the incoming tenant. Consider the following paragraph:

Tenant will have the exclusive right in the project to sell tiramisu. Tenant will have the exclusive right in buildings X and Y to sell Italian cuisine as its principal food item. Landlord shall not lease any other space in building X to a tenant that sells pizza in excess of 15 percent of such tenant's gross sales. The foregoing exclusive will continue

only for so long as tenant uses the premises for its permitted use.

Although the last sentence suggests that this paragraph constitutes only one "exclusive," it actually contains three separate restrictions on the landlord's ability to lease to other tenants. The first restriction prevents the sale of tiramisu and applies to the landlord's entire project. The third applies to the sale of pizza which comprises more than 15 percent of a tenant's gross sales and applies only to certain businesses. However, the second restriction prevents the sale of "Italian cuisine" which is not clearly defined.

Presumably, because the exclusive concerning pizza is more limited than the others, the landlord has determined that the sale of some pizza within the project is either more likely to occur than the sale of tiramisu and/or is more beneficial to the shopping center than the sale of tiramisu.

In addition to defining what use is limited, the landlord has also described when and where the use is limited. The landlord has limited the provision so that it only remains in effect as long as the protected tenant is conducting business as originally contemplated in the tenant's lease. Once the tenant with the exclusive stops selling some amount of pizza, tiramisu and Italian food, the exclusive use provision automatically ceases to bind the landlord in leasing its property for those uses.

Pros and Cons

Exclusive-use provisions are most frequently found in retail and mixed-use projects. The purpose of this kind of provision is to protect tenants when they are using the leased space to generate sales revenue. The exclusive not only justifies the tenant's initial investment in the lease, it also creates an opportunity for the tenant to establish itself at a particular location without interference from competing tenants.

Landlords benefit from the financial success of their tenants in various ways, which may include the consistency of rental payments, increased traffic generated by a tenant and payment of percentage rents. To the extent that an exclusive-use provision preserves a tenant's financial success, it may directly benefit the landlord. Exclusive-use provisions, however, can be a significant source of frustration. When a landlord grants an exclusive-use provision, it assumes the obliga-



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tion to tell future tenants that they cannot perform a certain use and then to ensure compliance by those tenants. As a result, a landlord may have to turn away a prospective tenant or declare that a breaching tenant has defaulted on its lease. In any such case, the exclusive use will cost the landlord time and money. In a worst-case scenario, the agreement to give an exclusive creates a future liability for the landlord. In at least one case, a court stated that a landlord's failure to comply with an exclusive-use provision in a lease created a "valid defense" to the landlord's claim for default (*Wettstein v. Love*, 583 S.W.2d 471, 474 (Tex. Civ. App.—El Paso 1979, writ denied)).

In light of the fact that exclusive uses are intended to restrict competition from surrounding tenants, some may question whether they are legally enforceable. However, Texas courts have expressly held that they are enforceable and that they run with the land (*Id.*). Moreover, in construing an exclusive-use provision, a court may find that a tenant's use that overlaps with a restricted use violates "the spirit and intent of the lease clause." Fluctuations in real estate markets may directly affect the prevalence of exclusive-use provisions in commercial leases. On one hand, some tenants may attempt to leverage weak markets to negotiate stronger protections and tenant-friendly provisions. On the other hand, when markets are soft, landlords may be particularly loathe to limit future leasing opportunities.

As tenant mixes in shopping centers vary and potential turnover increases, landlords may not be willing to invest in drafting and overseeing the provisions. At the same time, savvy tenants negotiating with mom-and-pop landowners may demand exclusives along with other concessions. Real estate markets may ebb and flow but the long-term success of a landlord or tenant will largely depend on planning. Inattentive drafting and failure to track exclusive-use provisions can create inadvertent breaches of leases and a host of unhappy tenants.

So, if a landlord determines that it is willing to grant exclusive-use provisions to certain tenants, the landlord should ensure that the exclusive-use provisions serve a meaningful purpose, are clearly described and appropriately limited and that the landlord or its property management company carefully read the various leases within a project to monitor and understand the relationship between overlapping exclusive-use provisions. ■

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