Is a Burrito a Sandwich?

Recent Cases Yield Restrictive Covenant Practice Pointers

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After rent or purchase price, one of the most important provisions in a retail lease or contract is the restrictive covenant. Retailers need them to prohibit competitors from setting up shop next door. Property owners reluctantly agree to them to persuade a retailer to purchase or lease from them. Negotiating restrictive covenants can be painful. Interpreting restrictive covenants later can be even more painful. This article will give practical tips to help practitioners draft clearer restrictive covenants, using recent cases as guides.

Beware a Gross Sales Limit

In *White City Shopping Center, L.P. v. PR Restaurants, LLC*, No. 2006196313, 2006 WL 3292641 (Mass. Super. Oct. 31, 2006), the court determined that the operation of a Qdoba Mexican Grill did not violate a restrictive covenant in Panera's lease regarding the sale of sandwiches. The restrictive covenant read as follows:

> Landlord agrees not to enter into a lease, occupancy agreement or license affecting space in the Shopping Center . . . permitting use [primarily] for a bakery or restaurant reasonably expected to have annual sales of sandwiches greater than ten percent (10%) of its total sales . . . .

White City, 2006 WL 3292641, at *1–2.

A restriction based on a percentage of gross sales seems temptingly objective—there are numbers involved—but whoever attempts to enforce the exclusive must determine the total amount of different products the alleged violator sells. To make that determination, the tenant might send the competitor a letter along these lines: "Hey, I think you are violating my restrictive covenant. Will you please disclose your confidential sales information so I know whether I should sue you?" Such a request would likely be met with resistance. Alternatively, the tenant could hire someone to sit in the competitor's store for some period of time to make an educated guess of both the store's total sales and how much of each individual item is sold in the store. In short, enforcing a restrictive covenant based on gross sales may present certain challenges.

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Beware a Floor Area Limit

Another recent restrictive covenant case is *Winn-Dixie Stores, Inc. v. Big Lot Stores, Inc.*, 886 F. Supp. 2d 1326 (S.D. Fla. 2012), in which the court considered how the Winn-Dixie supermarket chain's exclusive should be applied to nearly 100 dollar stores located in shopping centers anchored by Winn-Dixie in five different states.

Instead of focusing on gross sales, the Winn-Dixie exclusive allowed a certain portion of either the sales area or the storeroom area to be dedicated to the sales of the prohibited items:

> Landlord further covenants and agrees not to permit or suffer any property located within the shopping center to be used for or occupied by any business dealing in or which shall keep in stock or sell for off-premises consumption any staple or fancy groceries, meats, fish, vegetables, fruits, bakery goods, dairy products or frozen foods. . . .
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> [E]xcept the sale of such items is not to exceed the lesser of 500 square feet of sales area or 10% of the square foot area of any storeroom within the shopping center, as [an] incidental only to the conduct of another business . . . shall not be deemed a violation hereof.

Winn-Dixie, 886 F. Supp. 2d at 1336. Retailers that sell merchandise—as opposed to food—often take this approach when drafting an exclusive. But as the *Winn-Dixie* case illustrates, exclusives of this variety should also indicate how to calculate the relevant area.

Winn-Dixie took the position that the relevant area should include one-half of the adjacent aisle space, while the dollar stores contended that the relevant area should include only the area of the display units. In the end, the court agreed with the dollar stores and included only the area of the display units in determining that the dollar stores had not violated Winn-Dixie's exclusive. The court's decision is a cautionary tale for real estate practitioners.

Define Relevant Terms

The *Winn-Dixie* and *White City* cases also illustrate the importance of defining relevant terms in an exclusive provision. At the center of the dispute in the *Winn-Dixie* case was the interpretation of the term "staple or fancy groceries." Winn-Dixie took the position that this term should be interpreted very broadly, based on an annual publication by the *Progressive Grocer*, while the dollar stores argued that the term "groceries" should not include drinks or other dry goods based on the fact that the exclusive listed only food items. The court in *Winn-Dixie* took great pains to determine that the term does not include nonfood items and does include drinks (excluding alcoholic beverages). *Winn-Dixie*, 886 F. Supp. 2d at 1341–42.

In contrast, the *White City* case centered on the question of whether the term "sandwich" includes items such as quesadillas, tacos, and burritos. Counsel for Panera and Qdoba each found different dictionaries that supported their own definitions of a sandwich, and the court used a third dictionary to side with Qdoba's position that a burrito is not a sandwich.

These two cases illustrate that it can be dangerous to leave important terms in a restrictive covenant undefined. Better that the parties agree on the meaning of important terms when they negotiate the lease than later have a court use a dictionary to define the terms and argue about which dictionary definition should be used.

Revisit Defined Terms

Some of the many leases at issue in the *Winn-Dixie* case dated back to the 1950s. Perhaps when these leases were negotiated everyone knew what the term "staple or fancy groceries" meant, but today the meaning has been lost in the mists of time. Moreover, as the court pointed out, the items sold in a 1950s era grocery store differ markedly from those sold in a contemporary supermarket. Retailers should take a fresh look at their exclusive language from time to time to determine whether the language needs to be updated and clarified based on recent case law or changing operations.

Limit Extraneous Language

In an abundance of caution, the landlord in the *White City* case specified that the exclusive, which specifically prohibited bakeries and certain restaurants that serve sandwiches, did not apply to a business serving near-Eastern food ("[t]he foregoing restriction . . . shall not apply to (i) use of the existing, free standing building in the Shopping Center partially occupied by Strawberries and recently expanded for a business serving near-eastern food and related products"). *White City*, 2006 WL 3292641, at *2. That clarification opened the door for Panera to argue that the parties must have meant the term "sandwich" to be broad enough to include items such as gyros; otherwise, the language regarding near-Eastern food was unnecessary. Panera would not have been able to make this argument if the landlord had let the language in the exclusive speak for itself.

Be Careful About Listing Competitors

In *2000 Clements Bridge, LLC v. OfficeMax North America, Inc.*, No. 11-57 (JEI/KMW), 2012 WL 3600285 (D.N.J. Aug. 21, 2012), the court held that the operation of an h.h. gregg appliance store did not violate an OfficeMax exclusive that provided in part as follows:

> Landlord . . . shall not enter into a lease or sale of any portion of the Shopping Center . . . for the following:
>
> (a) For the purpose of, or which is permitted to be, the sale of office, home office, school or business products, computers and computer products, office, home office, school or business supplies or equipment; office furniture; or electronics (including by way of example those businesses operated by Office Depot, Staples, Office Shop Warehouse, Mardel Christian Office and Education Supply Store, Mail Boxes etc., and Workplace); or for use as a business support center. . . .

2000 Clements Bridge, 2012 WL 3600285, at *1.

Because this exclusive included both a description of prohibited products and a somewhat awkwardly inserted parenthetical that mentioned certain businesses, the court determined that the listed products were prohibited only if they were sold by the listed businesses. Putting aside the question of

whether that was a correct result, the case illustrates the need to be very clear, when including both a formula for prohibited stores and a list of prohibited stores, about how the one relates to the other. A new sentence would have been clearer than the parenthetical, and the lead-in to the sentence should have been "in addition, and not by way of example."

Describe Exceptions Broadly

Another lesson learned from the *2000 Clements Bridge* case is that if certain pre-existing tenants are not subject to an exclusive and the landlord wants to continue to preserve the tenants' space for a similar use if they leave the shopping center, that goal should be clearly stated in the lease. In other words, instead of indicating that a new tenant's exclusive does not apply to a specific existing tenant, a landlord should indicate that the exclusive does not apply to a store containing more than X square feet that sells Y items.

Perform a Title Search

Before purchasing or leasing space in a shopping center, a retailer would be well-advised to review a title report to determine whether any existing exclusives that might limit the retailer's use of its space have been recorded. The *Winn-Dixie* court had to interpret the law of various states where the stores at issue were located to determine whether the exclusive was a real covenant running with the land and thus binding on Winn-Dixie's cotenants. In Georgia and Alabama, a tenant has constructive notice of recorded restrictions in the lease of a cotenant. In Florida, a tenant is bound by an exclusive in another tenant's lease if the exclusive is a covenant running with the land and the tenant has notice of it, but a tenant does not have constructive notice of a recorded restriction. In another case involving Winn-Dixie and a dollar store, however, the dollar store was found to have implied actual notice of Winn-Dixie's exclusive because the dollar store was an experienced commercial tenant. *Winn-Dixie Stores, Inc. v. Dolgencorp, Inc.*, 964 So. 2d 261, 266 (Fla. Dist. Ct. App. 2007). In the context of restrictive covenants, it seems, willful ignorance by the cotenant is not bliss.

Pick Your Victim and Your Poison

The *Winn-Dixie* cases are somewhat unusual in that the parties were both tenants instead of a landlord and a tenant. Pursuing an action against another tenant instead of a landlord raises the question of whether a retailer's exclusive is binding on the cotenant in the first place. As highlighted in the previous paragraph, this analysis tends to be very state-specific and yields mixed results.

The 2012 *Winn-Dixie* case also shows that if a retailer is able to enforce its exclusive against another tenant, it may be difficult to prove damages. Although several Winn-Dixie witnesses opined that the existence of the dollar stores caused Winn-Dixie to lose sales, the court found their testimony unconvincing. One witness, for example, stated that violations of grocery exclusives result in lost sales to Winn–Dixie because "[i]f a loaf of bread is bought in a Dollar General store, that loaf of bread will not be bought at a Winn–Dixie store." *Winn-Dixie*, 886 F. Supp. 2d at 1346. Another witness testified about an industry model estimating that about 30% of a grocery market share will be lost to nontraditional grocery operators. Id.

The court rejected the testimony as being "too general, vague, and speculative"—not only because the witnesses were unable to identify a specific amount of lost sales but also because the witnesses could not link the lost sales to the specific defendants. "At most, Plaintiffs' witnesses talk about dollar stores generically" and "lumped the dollar stores together with all 'non-traditional' grocery sellers" without acknowledging the distinctive sizes and offerings in the defendants' stores. The court also noted that the exclusive provision allowed other tenants to sell some amount of the prohibited items, but the witness testimony failed to differentiate between allowed and prohibited sales.

In short, the case highlights several difficulties with proving damages that result from violation of an exclusive provision. As a result, practitioners may find that liquidated damages provide a better approach.

Conclusion

The *Winn-Dixie*, *White City*, and *2000 Clements Bridge* cases provide cautionary tales for the real estate practitioner when drafting lease provisions to shelter a retail tenant from competition from other tenants. The cases also illustrate a number of tips that the practitioner should keep in mind when drafting exclusive provisions. n