

Landmarks

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Eyes Without a Face: Showrooming and Retail Leases



Barry J. Guttman

Technologically savvy shoppers visiting brick-and-mortar retail locations are increasingly engaging in “showrooming,” a practice where consumers use the brick-and-mortar retail location to evaluate a product in person, yet comparison shop and ultimately buy the product online from the retailer’s online store or from a competitor’s online store, often because the product can be bought more cheaply online. The advances in smartphone and mobile technology now allow shoppers to concurrently showroom and complete their purchases on their phones, often while still standing

in the brick-and-mortar store. With the rise of showrooming as a new trend in retail, landlords and tenants alike need to be mindful of leasing issues that can arise.

Showrooming raises issues that can implicate several provisions commonly found in retail leases: (1) gross sales; (2) go dark and cotenancy; (3) with respect to Internet access, utilities and tenant improvement allowances; (4) compliance with laws; (5) common areas; and (6) use restrictions.

Accounting for Showrooming in Gross Sales

Showrooming can give rise to tensions between landlords and tenants over whether purchases from the online store of a brick-and-mortar tenant are included with the definition of gross sales under that tenant’s lease. Accurately capturing gross sales in the lease helps ensure that (a) tenants’ right to terminate their leases through sales kick-out provisions is not broader than the parties intended at lease execution and (b) tenants are paying the proper amount of percentage rent owed under their leases (if any). For those reasons, the definition of gross sales must be carefully drafted to ensure that tenants’ gross sales attributable to their premises are not under- or over-reported.

Showrooming’s Effects on Actual Sales: Go Dark and Cotenancy Issues

Showrooming can affect a tenant’s actual sales at its brick-and-mortar store by causing that tenant to lose business to an online competitor. If a tenant’s sales actually drop, then that tenant may seek to go dark or downsize its premises as a way of maintaining profitability, which could affect not only that tenant, but a landlord’s entire shopping center by triggering cotenancy provisions in other tenants’ leases. The potential domino effect may threaten the viability of the shopping center and diminish future financing opportunities.

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The Internet Access Predicament

In light of the potentially adverse effects of showrooming on sales at brick-and-mortar retail locations, should landlords and tenants alike look to fight fire with fire and leverage online technologies to stay ahead of competing online retailers? Increasingly, landlords and tenants appear to be answering this question in the affirmative. Technologies like location-based marketing are being used in attempts to drive traffic to retail locations. Location-based marketing seeks to provide targeted marketing and advertising to potential customers within a certain geographic area by utilizing “geo-fencing,” software that defines specified boundaries to create a virtual barrier that triggers a smartphone’s GPS when the phone enters or exits those boundaries. Geo-fencing can be used to automatically send text messages, emails, notifications or other promotional alerts to a user who has downloaded an app that enables his or her smartphone’s GPS to be triggered by the geo-fencing boundaries. This app often stores a user’s personal information, shopping history and payment information to optimize sales by sending targeted promotions and allowing quick point-of-sale payment. Geo-fencing provides an opportunity for potential customers to engage with retailers and creates brand and shopping center loyalty.

The use of geo-fencing and similar Internet-reliant technology raises another leasing concern: provision of Internet access. Under the lease, is the landlord required to provide Internet access or infrastructure necessary for Internet access? In light of the FCC’s recent decision to treat broadband Internet access as a utility, can a tenant reasonably argue that its landlord’s obligation to generally provide utilities under an existing lease includes an obligation to provide broadband Internet? Moving forward, should new leases treat Internet access as a utility? To what extent, if any, can tenants use tenant improvement allowances to cover the costs associated with providing Internet access? While the rise of showrooming may weigh against providing Internet access, the concurrent rise of geo-

fencing and other web-based technology aimed at enhancing the retail experience may weigh in favor of providing Internet for prospective customers. Accordingly, landlords and tenants should carefully negotiate provisions regarding Internet access and related infrastructure.

The Data Breach Dilemma: Compliance with Laws

Providing Internet access and maintaining apps that store personal information from shoppers’ phones can expose landlords and tenants to significant liability if the app’s underlying systems are compromised or there is a data breach. A party providing Internet access or an app will need to craft an end-user license agreement and a privacy policy that absolve the Internet or app provider of liability to the shopper. Even if such an agreement is in place, that party may nonetheless be in breach of its obligation under its lease to comply with applicable laws. Particularly given that the standard for liability in data breaches is still evolving, any party providing Internet access or storing personal information should adhere to the latest data security and privacy standards. These concerns also implicate indemnity and insurance obligations, so each party will want the lease to carve out its liability and require the other party to provide indemnification and carry insurance in connection with data breaches.

Common-Area Questions

Showrooming and location-based marketing implicate common-area provisions in leases in at least two different ways. One, tenants are generally prohibited from soliciting business, advertising and/or conducting promotional activities in the common areas. If a tenant uses location-based marketing and its “geo-fence” extends outside the its premises and into the common areas, then that tenant may have violated that prohibition. Two, if a landlord provides shared Internet access for tenants or Internet access within the common areas, then the landlord will want to pass through a share of the costs associated with that Internet access to tenants as a common-area charge. Moving forward, landlords and tenants should

both ensure that their leases address these common-area issues.

Use Restriction Requirements

Showrooming and, more broadly speaking, a retailer’s online presence can implicate a lease’s use provisions. Tenants looking to provide some form of Internet access need to ensure that their lease’s permitted-use language does not prohibit them from providing that access. Tenants with online stores also need to verify the extent, if any, to which the exclusive or prohibited-use provisions apply to the products they can sell online. For example, a tenant may be prohibited from selling certain goods within its premises, but that tenant’s online store may be selling the prohibited goods. If the tenant completes a sale of that good via in-store showrooming, then has the tenant violated its use restrictions? Whether or not a violation has occurred will depend on how broadly or narrowly the use provisions have been drafted.

Conclusion

All this having been said, practically speaking, how can brick-and-mortar landlords and tenants take advantage of rapid technological developments, respond to showrooming and remain competitive with online retailers? At absolute minimum, they can ensure their leases address the concerns described above. However, these are not the only technological issues facing landlords and tenants today. Properly navigating the sea of these complex issues requires legal and financial counsel well-versed in the most current retail trends and technology. We at Benesch are closely monitoring these advances to ensure that we advise our clients regarding all of their leasing and real estate concerns, while providing information and expertise to keep both landlords and tenants in front of trends in the changing retail landscape.

For more information, please contact **BARRY J. GUTTMAN** at bguttman@beneschlaw.com or (216) 363-4547. **KELLY M. KOZICH** and **AARON MENDELSON** contributed to the preparation of this article.

Retail Leasing Due Diligence and Lease Protections Top 10 Items to Consider



Norman W. Gutmacher

You need to lease a new location for your retail store. The proposed location is either a local neighborhood strip shopping center (not a mall), a freestanding building or a vacant parcel. You have identified the new location you believe you want, but are not sure what to do next. Here are the Top 10 items to consider before entering into a lease.

- 1. Ownership.** Verify who, in fact, owns the property you intend to lease and that the person with whom you are negotiating has authority to negotiate for the owner. To verify who owns the property, you will likely need to have your attorney and/or a title company check the County Records office where deeds are filed. It is important that your lease correctly identifies the legal owner of the property. If the person with whom you are negotiating does not have authority, you may be in a position where you make, but cannot obtain, concessions, because the person with whom you are dealing is not authorized to bind the owner. It is also important to verify that the owner has the financial capability to perform its obligations under the lease. In situations where you are performing significant tenant work in exchange for a cash allowance from the owner, consider obtaining financial assurances prior to executing a lease.
- 2. Letter of intent or term sheet.** Before negotiating the lease, flesh out the key business terms with a letter of intent or term sheet. A properly drafted term sheet can save time and money by shortening the lease negotiation.
- 3. Inspection of the building and major common areas.** Have your space and the building inspected by a licensed professional who inspects commercial buildings. The inspection should include the roof, the HVAC system, parking lot, access drives and other potentially big-ticket items. If you are a relatively small tenant in a large building, instead of having the entire building inspected, you may want to limit your inspections to “major” repair or replacement items to the building that might be passed through to you as a common-area expense (see below).
- 4. Mortgages or deeds of trust.** Ascertain whether or not there are any mortgages or deeds of trust encumbering the property. Once again, this will likely involve your attorney or a title company performing a title search to determine whether a mortgage or deed of trust has been recorded. If there is a mortgage or deed of trust, then you will want to be certain that the lender either has no right to review or approve your lease, or that if the lender has such a right, that your lease is approved in writing. In addition, you will likely need to obtain a “non-disturbance” agreement from the lender that protects you if the property owner defaults on its loan. Without a nondisturbance agreement, if the property owner defaults, the lender may be able to terminate your leasehold rights. In addition, you will want to be sure your lease permits you to prepare and have executed a memorandum of lease summarizing the material terms of your lease. When the lease is executed, the memorandum of lease should be placed on record in the County Records office.
- 5. Environmental.** Ascertain whether there are any environmental issues that could adversely affect the location. This will involve engaging an environmental consultant to determine whether there are any likely environmental issues, such as asbestos (which could be in floor tiles, ceiling tiles and other places), mold and other possible hazardous substances. Depending on your lease, you may need this information not only for your store premises but also for the entire project—particularly if there is any possibility that the property owner might pass through to you pursuant to the lease any of the costs relating to remediating any environmental issues.

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Get to Know Lee Korland



Lee Korland

What Lee wants you to know about the real estate industry: There is a lot of demand right now for high-quality real estate, especially when it comes to the retail and multifamily sectors. Whether you are a

buyer looking to expand an existing portfolio, an investor with equity for potential new projects or a lender looking to make new loans, the market is extremely competitive when it comes to well-positioned assets. With all the competition chasing a limited number of opportunities, it is more important than ever to have a team in place that can be agile and move quickly when opportunities do arise and to continually look for ways to derive additional value from underutilized real estate.

What Lee is doing when he isn't practicing law: I can be found spending time with my family (which usually means I'm watching my daughters in a new theater production or rooting on their soccer team), or I can be found cheering for my Cleveland sports teams.

Lee's favorite hobby: I love playing all types of games—everything from baseball, basketball, golf and tennis to card games and board games.

The best thing about being a real estate attorney: Every piece of real estate is unique and has its own complexities and challenges. That means I'm always seeing something new. I also love being part of development and redevelopment projects, where you can actually go see the finished product and know that you had a small part in bringing that project to fruition.

Lee's favorite thing about living and working in Cleveland: Personally, I believe Cleveland is a wonderful place to raise a family, as it has world-class museums and theaters, lots of parks and opportunities to be outdoors, and Clevelanders have a strong sense of community and hard work. From a professional perspective, Cleveland offers a sophisticated legal community and a large number of nationally prominent real estate-focused companies.



Eight attorneys from Benesch’s Real Estate & Environmental Practice Group attended the annual ICSC RECon shopping center convention from May 17–20 in Las Vegas. The convention is the premier global gathering of shopping center industry professionals, and approximately 35,000 people attended the convention this year. During the course of the convention, the Benesch team hosted over 200 clients, colleagues and friends at a cocktail reception. Attending the convention also allows Benesch’s real estate team to stay on top of cutting-edge retail real estate trends, while networking with national and regional developers, property owners, tenants, lenders and other sources of capital. In terms of trends that were evident at the convention, there continues to be tremendous demand and competition for high-quality retail assets, and cap rates on these assets continue to fall. Furthermore, many development projects that were shelved during the last recession are now moving forward, and leasing activity is increasing as many retail tenants are again looking to grow after years of downsizing or being stagnant. Benesch works with clients on retail real estate acquisitions, dispositions, leasing matters, and development and redevelopment projects that they are pursuing across the country.



(L to R) Rob Ondak, Benesch; Bernie Miller; Craig Miller, Duffy & Duffy Cost Segregation Services, Inc.; Jim Schwarz, Benesch

(L to R) Jeff Wild, Benesch; Nico Bolzan, Brown Gibbons Lang & Company LLC; Athena Callas Gallo, Brown Gibbons Lang & Company LLC; Gabriella Milana Gallo



(L to R) Brent Troy, The National Bank of Indianapolis; Jeff Abrams, Benesch; William Redman, The National Bank of Indianapolis

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6. **Zoning.** Verify that you can obtain the necessary store approvals and signage rights and, if the site is an “end cap” or is a freestanding location, a drive-thru window. Also, confirm main access routes and curb cuts to and from the major access routes (e.g., are there “right in, right out only” access points?; does current zoning permit additional curb cuts?). Your architect or attorney should be able to assist you with this.
7. **Parking protection.** If parking near the location is limited, you will want protection in your lease that existing parking satisfies zoning regulations and there will not be nearby tenants that will be intensive, long-term users of parking, such as hair salons and fitness centers.
8. **Restrictions on other tenants.** If your location is not a freestanding building site, you will want protection in your lease from future adjacent tenants that could cause you operational problems. For example, the odors emanating from a beauty salon or pet store may not be the best thing coming into your store. In addition, you may want to negotiate an exclusive use for the location and be sure to include within the restricted area any adjacent land owned by owner or an affiliate of owner. As part of the exclusive-use negotiation, ask the owner to confirm that no other tenant has the right in its lease to change to a use that would be competitive with your use.
9. **Experiences of other tenants.** Contact existing tenants in the location. Ask them if they have had any issues with the property owner, such as lack of responsiveness to necessary repairs or maintenance. Ask them how business has been—whether it’s been increasing or decreasing; and, if the latter, what they think the reasons may be. Try to find out both from the tenants and the police department if there have been any incidents in the shopping center, such as car thefts or assaults.
10. **Cost control.** If you are in a shopping center, you will want to review at least three years of historic Common Area Maintenance (CAM) pass-through expenses to establish a pattern of how the CAM expenses change from year to year. In addition, you may want to attempt to negotiate a “cap” in your lease that would limit year-to-year increases in CAM expenses and exclude expenses that are capital in nature, such as those required for the owner to comply with laws (e.g., changes to comply with Americans with Disabilities Act) or that relate to correcting pre-existing conditions (e.g., environmental remediation) or are incurred entirely for the benefit of another tenant or another tenant’s use. This can be particularly important in an older shopping center.

The foregoing does not constitute legal advice. Consult an attorney with respect to your particular situation.

For more information, please contact **NORMAN W. GUTMACHER** at ngutmacher@beneschlaw.com or (216) 363-4591.

RECENT TRANSACTIONS

- Represented Stark Enterprises on the acquisition and development of the nuCLEus Development Project, a transformational project for downtown Cleveland. nuCLEus will have commercial critical mass of almost 150,000 SF of national restaurant and retail tenants, 500 apartment units, 200,000 SF of executive office space and nearly 1,500 parking spaces.
- Representing a developer in the approximately \$150 million CMBS refinancing of an existing mixed-use lifestyle center.
- Represented a national lending institution in the financing of a \$25 million student housing building. The University of Indianapolis recently broke ground on a four-story, 480-occupant apartment building designed to expand housing options for students. A joint venture with developer Strategic Capital Partners, the estimated \$25 million project is part of Ulndy's plan to improve the campus experience while also elevating the quality of life in the surrounding University Heights neighborhood.
- Representing an overseas-based company in connection with the acquisition and development of land in the southeastern United States for purposes of building a new U.S. headquarters with an investment of approximately \$100 million.
- Represented developers, RealtyQwest – Baldwin Companies and Yeager Properties, in the negotiation and closing of a public-private partnership transaction that resulted in the development of The Post at Ft. Harrison, a mixed-use building in Indianapolis comprising office suites and 10,000 SF of retail space, which opened in May 2015.
- Represented a developer of affordable and market rate multifamily housing in connection with the \$5 million acquisition of a multifamily property in Missouri.
- Represented a Northeast Ohio company in the acquisition of a building and land, including the negotiation of a Development Agreement with the city, in connection with the redevelopment of the site.
- Represented the owner in the \$13+ million refinancing of a 116,000 SF grocery-anchored shopping center in Tennessee.
- Represented a publicly traded REIT in the disposition of land in Gulfport, Mississippi, in connection with the development of a car dealership.
- Representing a developer of affordable and market-rate multifamily housing in connection with the \$19 million acquisition of a nine-property multistate portfolio located in the southeastern U.S.
- Represented the purchaser in the acquisition and Fannie Mae-backed financing of a 150+ unit multibuilding apartment complex in Florida for a purchase price in excess of \$9 million.
- Represented the purchaser in the acquisition of a 76,000+ SF shopping center for a purchase price in excess of \$4.8 million.
- Represented the purchaser in the acquisition of a 150-unit multibuilding apartment complex in Florida for a purchase price in excess of \$7 million, including the assumption of existing HUD indebtedness on the property.
- Represented the owner in the \$6.8+ million refinancing of a 120+ unit multibuilding apartment complex.
- Represented the owner in the \$10+ million refinancing of a 98,000+ SF grocery-anchored retail shopping center in Massachusetts.
- Represented a real estate fund in the acquisition and financing of a grocery-anchored shopping center in Virginia for a purchase price of approximately \$9 million.

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Kevin J. Kessinger and Kathryn Kramer Gaydos have joined the Real Estate & Environmental Practice Group



Kevin J. Kessinger

Kevin brings almost 20 years of extensive commercial real estate and finance experience to the firm. His practice will focus on all aspects of commercial real estate transactions and management, including acquisitions, dispositions, joint ventures, developments, capital markets transactions and operations. In addition to his role at Benesch, Kevin will remain active in the corporate and private equity sectors, advising his clients on all aspects of their commercial real estate holdings and contemplated acquisitions.



Kathryn Kramer Gaydos

Kathryn's practice involves a variety of real estate matters, including commercial leasing, acquisition and disposition of commercial property, and due diligence review. She has experience drafting and negotiating leases and purchase agreements (and other ancillary documents), analyzing various real estate issues (such as lease violations, consent requirements, and title and survey matters), and managing complex real estate transactions.

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