

CHALLENGING RADIUS RESTRICTIONS IN SHOPPING CENTER LEASES

Nina L. Kampler, Esq.
Polo Ralph Lauren Corporation
New York, New York

Harold B. Pomerantz, Esq.
Piper Rudnick
Chicago, Illinois

I. General Prevalence

- A. General purpose of radius restrictions
- B. Anticipated results for landlords
- C. General duration
- D. Geographic scope
- E. Typical exclusions

II. Legal History

- A. Disfavored in earlier times
- B. Growing acceptance with urbanized society
- C. Sherman Anti-Trust Act

III. Present Legal Environment

- A. “Reasonable” restraint of trade
- B. Scarcity of reported cases
- C. Factors evaluating “reasonableness”
- D. Changed circumstances
- E. Lease negotiations process
- F. Reformation as an alternative

American Bar Association
Section of Real Property, Probate and Trust Law
2003 Annual Spring Symposium
New York, New York
April 3, 2003

14th ANNUAL REAL PROPERTY SYMPOSIUM

**“I CAN’T GIVE IT AWAY ON SEVENTH AVENUE:
WHAT EVERY LANDLORD AND TENANT SHOULD KNOW
IN TODAY’S RETAIL REAL ESTATE MARKET”**

**CHALLENGING RADIUS RESTRICTIONS IN
SHOPPING CENTER LEASES**

Nina L. Kampler, Esq.
Polo Ralph Lauren Corporation
New York, New York

Harold B. Pomerantz, Esq.
Piper Rudnick
Chicago, Illinois

CHALLENGING RADIUS RESTRICTIONS IN SHOPPING CENTER LEASES

Nina L. Kampler, Esq.
Polo Ralph Lauren Corporation
New York, New York

Harold B. Pomerantz, Esq.
Piper Rudnick
Chicago, Illinois

A. Prevalent in most commercial shopping center leases.

1. The general purpose of a radius restriction clause is to avoid having a competitor duplicate the developer-landlord's tenant mix in close proximity to the developer's shopping center.
2. Anticipated Results:
 - a. Allows the existing shopping center to become "established" in its marketplace.
 - b. Potentially retards the development of competing shopping centers in close proximity to the developer-landlord's center.
 - c. Protects the developer-landlord's percentage rental income generated by specific tenants.
 - d. Protects the developer-landlord against erosion of its customer base¹

¹ Jay Lentzer, The Antitrust Implications of Radius Clauses in Shopping Center Leases, 388 PLI/Real 485, 488 (1993).

3. The duration of the radius restriction clause is often dependent upon the relative bargaining power of the landlord and the tenant. The developer-landlord will typically seek to have the radius restriction last the entire term of the lease.
4. Similarly, the developer-landlord will typically seek to have the radius restriction cover as broad an area as possible.
5. General exclusions include existing locations and locations acquired in bulk from another retailer with a resultant change in use and trade name.

B. Legal History.

1. The common law frowned upon agreements which restricted traditional means of commerce and, accordingly, radius restriction clauses were narrowly interpreted.²
2. Courts began to re-examine radius restrictions with the growth of urban centers,³ and soon began to enforce these clauses when they were designed to protect a legitimate business interest, and were restricted in both scope and duration.⁴
3. We began to see certain challenges to radius restriction clauses as a violation of the Sherman Anti-Trust Act in the 1960's.⁵ The Sherman Act was intended to preserve and promote free competition, but the statute has been interpreted as

² Mitchell Herman, The Practical Problems of Enforcing Restrictive Clauses, 11 No. 6 Com Leasing L. & Strategy 6 (1998).

³ See Lentzer, supra note 1 at 510

⁴ See Herman, supra note 2

⁵ See Lentzer, supra note 1, at 517

providing that unreasonable restraints of trade would be deemed violative of the Act.⁶

4. In the absence of clear case law, courts have seemed willing to examine the scope and reasonableness of radius restrictions based upon their “anti-competitive” nature.
5. Many of these actions are brought via state court proceedings. Most state anti-trust statutes mirror the Sherman Act in their application.⁷

C. Present Legal Status

1. Many states will recognize radius restriction clauses as restraints of trade and examine whether they (a) protect a legitimate business interest, and (b) are no broader than necessary to protect that interest.⁸ Some states have opposed analysis of a radius restriction clause’s scope and duration under the “freedom to contract” theory.⁹
2. There is not a large number of reported cases challenging radius restrictions because the stakes are so high for both the landlord and the tenant. Most radius restriction challenges are settled for either monetary consideration or result in the reformation of the lease documentation, or some combination of both.

⁶ See Alfred M. Meyerson, Radius Restrictions in Shopping Center Leases, in #2000 ICSC U.S. Shopping Center Law Conference §IV at 3 (2000).

⁷ See Lentzer, *supra* note I, at 524

⁸ See, e.g. (2.1d. World v. South Towne Center Ltd., 6347 Supp 1121 (S-C Ohio 1986)

⁹ See, e.g. Osage Glass, Inc. v. Donovan, 693 S.W.2nd 7 (Mo Banc 1985)

3. Recent cases suggest that in an injunction context, courts should refrain from granting tenants relief because market factors should take care of reasonable settlements.¹⁰
4. There are eight (8) factors which courts may consider when evaluating the “reasonableness” of a radius restriction clause:
 - a. “The intention of the parties when the covenant was executed, and whether the parties had a viable purpose which did not interfere with antitrust laws, or public policy.
 - b. Whether the covenant had an impact on the considerations exchanged when the covenant was originally executed.
 - c. Whether the covenant clearly and expressly sets forth the restrictions.
 - d. Whether the covenant was in writing.
 - e. Whether the covenant is reasonable concerning area, time or duration.
 - f. Whether the covenant imposes an unreasonable restraint on trade or secures a monopoly for the covenantor.
 - g. Whether the covenant interferes with the public interest.
 - h. Whether, even if the covenant was reasonable at the time it was executed, changed circumstances make the covenant unreasonable.^{11,”}
5. Courts are also likely to examine the relative bargaining power of the landlord and the tenant when the lease was originally negotiated. Some courts may

¹⁰ See, e.g. Walgreen Co. v. Salt Creek Property Co., B.V. 966 F.2nd 273(7th Cir. 1992)

¹¹ Jennifer E. Doty, The Effects of Electronics Commerce on the Traditional Shopping Center Lease, 6 Tex. Wesleyan L. Rev. 85, 95(1999)

balance the parties' interest and look at the balancing test set forth within the Restatement of Contracts, Second §188:

- a. A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade if
 - (i) the restraint is greater than is needed to protect the promisee's legitimate interest, or
 - (ii) the promisee's needs are outweighed by the hardship to the promisor and the likely injury to the public.¹²

D. Reasonableness of the Clause

Some courts may examine the “reasonableness” of the radius restriction clause. Courts will rely upon the general case law that a state typically frowns upon anti-competitive contracts. State law controls these decisions.

1. If a court shows a willingness to examine the “reasonableness” of the scope and duration of a radius restriction, the tenant needs to establish a strong equitable position to prevail.
 - a. A radius restriction which precludes a tenant from operating within an entire geographic market may be stricken on an anti-competition basis. For example, a radius clause providing; “During the entire term of this Lease, the demised premises shall be Tenant's only store in a twenty (20)

J.C. Nichols Company v. Eddie Bauer, Inc., USDC W.D. No. Case No. 98-0370-CU-W-6 at 7¹²

mile radius” may be found to be overly broad if the shopping center is situated in an urban center.

- b. Courts may examine the need for a certain term of years or geographic breadth.
 - c. What is “reasonable” in a rural environment may not necessarily be deemed “reasonable” in an urban environment, with its much denser concentration of both people and retail facilities.
 - d. From an equitable standpoint, a tenant may need to demonstrate changed circumstances or a substantial reason to examine the radius restriction clause. This may be easier to do now than historically, particularly over the last ten (10) years, in which theories of synergy and the marketplace have changed.¹³
2. Some courts have shown a willingness to reform rather than entirely strike a truly oppressive radius restriction clause.
- a. “Equity” is an important concept in these analyses, and a tenant may have to explain the genesis of the specific restriction. The tenant will be required to make a compelling argument to overcome the argument that contracts are to be strictly enforced.
 - b. The tenant may be able to prevail if it lacked accurate information about the landlord’s position on the radius restriction clause at the time it entered into the lease, or possibly when dealing with a radius restriction clause of

¹³ Osage Glass, Inc. v. Donovan, 693, S.W.2d 71, 75 (Mo. Banc 1985)

a long duration, where market forces and demographics have changed from when the clause was originally negotiated.

c. The tenant may also be able to prevail if it can show that unequal bargaining power existed between it and the landlord during the lease negotiations. This may be a less successful argument today than in the past, given that many tenants today are “nationalized”. However, it might prove to be a useful argument in the context of single entity/single location tenants.¹⁴

3. The tenant may also prevail if the tenant can demonstrate that the scope of the radius restriction, as originally negotiated, was not truly necessary to protect the landlord’s business interest because the landlord was not consistent in the application of the radius clause with other tenants.¹⁵

a. All “like tenants” are not subject to identical radius restrictions (particularly in terms of scope, geographic area and duration).

b. The landlord might be able to demonstrate why differing sets of restrictions are being applied to different tenants, or different types of tenants.

E. Courts may strictly enforce negotiated radius restrictions:

1. Rationale: Parties with equal bargaining power negotiated a contract, and standard contract analysis binds parties to their agreement. Courts assume that

¹⁴ Value Properties, Inv. v. King’s Dept. Stores, Inc. 505 F.Supp 92 (N Mass 1991)

¹⁵ Winrock Enterprises, Inc. v. House of Fabrics of New Mexico, 579, P.2d 787 (N.M. 1978)

both parties made the best deal in their own economic self-interest. “You signed, you are bound.” “A deal is a deal.”¹⁶

These courts assume that the radius restriction clause was “traded” for other economic benefits within the lease during the lease negotiation process.

2. The doctrine of complete involvement in which courts will not permit parties to a fully executed agreement from changing a single term in a contract if no misrepresentations were made by the other party.¹⁷
3. Some states have a line of cases strictly interpreting any restrictive covenant pertaining to land. These cases presume irreparable harm whenever there is a violation of a restrictive covenant relating to land. These cases do not require a showing of irreparable harm (such a showing of irreparable harm is assumed).¹⁸
4. Sympathetic courts may want to see a public policy rationale for challenging a radius clause. For example, demographic changes within a geographic area, shoppers having demonstrated an unwillingness to travel great distances, traffic congestion and related problems, time away from home, etc.

F. Another Context Emerging.

Anti-trust challenges by other competing developers that argue that radius restriction clauses hinder their entrance into a geographic market. This argument may arise in the

¹⁶ See U.S.A. Chem. Inc. v. Lewis, 587 S.W.2d 15, 24 (Mo. App. W.D. 1977)(Contractual restrictions pose no undue hardship to a party who has voluntarily assumed them as a part of a negotiated contract which has benefitted the party)

¹⁷ Waldorf Shopping Mall, Inc. v. The Great Atlantic and Pacific Tea Co., 1984 WL 15690 (Mo. Cir. Ct.)

¹⁸ Dean v. Monteil, 239 S.W.2d 337 (Mo. 1955); Sheperd v. Spurgeon, 291 S.W.2d 162 (Mo. 1959)

context of a large, well established shopping center with a “far reaching” radius restriction.

1. An important issue arises about the context in which the new developer can challenge third party contracts: the standing of a third party to challenge a bilateral agreement.
2. The “new” developer would need to be able to demonstrate the true uniqueness of the restricted tenants and the desire for tenants (preferably more than one) to compete with its other store in a new market.