

REAL ESTATE

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Tenants also have power of consent

Commercial landlords may need tenant consent to develop property.

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IN A COMMERCIAL tenancy, the tenant typically must obtain consent of the landlord to assign or sublet the premises. The common law is well-settled: Unless specifically stated otherwise in the language of the lease, a landlord must not unreasonably withhold consent when a tenant is seeking to alienate its interest. But what about the reverse, albeit somewhat less common, situation where a landlord must obtain tenant consent in order to further develop the property? Typically, tenant consent obligations arise in shopping centers where major tenants have negotiated the right to approve or reject further construction that affects their business.

The Restatement (Second) of Property: Landlord Tenant has established: "If a

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denial of a request for consent to a proposed transfer is accompanied by a statement of the reason or reasons for the denial, then the party seeking the consent proceeds at his risk if he goes through with the proposed transfer. The burden of proof will be on him to establish that the reason or reasons advanced are unreasonable." Restatement (Second) of Property: Landlord Tenant § 15.2, cmt g. (1977).

The same comment also explains that in order for the grounds to be reasonable, they "must be objectively sensible and of some significance and not based on mere caprice or whim or personal prejudice."

Although the Restatement standard frequently has been cited in court decisions involving the reasonableness of a landlord's refusal to consent, there are only a handful of reported court decisions nationally that address the reverse situation, where a commercial lease mandates that a landlord obtain tenant consent to site modifications or further construction. Those decisions, which interestingly are all federal, generally hold that the Restatement rule applies and provide the tenant

with broad latitude in determining whether the landlord's proposed improvements will adversely impact the tenant's business.

Recent case requires tenant to have 'valid business reasons.'

The most recent decision addressing the reasonableness of a tenant withholding consent from a landlord is *Safeway Inc. v. CESC Plaza Ltd. Partnership*, 261 F. Supp. 2d. 439 (E.D. Va. 2003). In *Safeway*, a supermarket leased space in an Arlington, Va., shopping plaza. The lease contained a clause requiring the landlord, after completion of initial construction of the shopping plaza, to obtain Safeway's consent for any future alterations to the common areas (including parking).

The shopping plaza encompassed about 40 stores, located on the ground floor of the "Plaza Block." The Safeway store opened onto the interior of the Plaza Shops mall. Therefore, customers entering from the surface parking lot would have to walk down an interior mall corridor, approximately 100 feet in length, to reach the store entrance. A two-story parking structure ran alongside the plaza between the roadway and the structure containing the stores.

The question presented involved whether Safeway acted reasonably in withholding consent to the landlord's \$40 million proposed renovation of the Plaza Block and surrounding area, which included the removal of the parking structure used by Safeway customers and the construction of new retail stores.

Burden placed on landlord

In determining whether a tenant has unreasonably withheld consent, the *Safeway* court first adopted the Restatement rule that places on the party seeking consent the burden of demonstrating that the other party acted unreasonably rather than objectively, and not on "mere whim or caprice." *Id.* at 462-463. The court next established what can be seen as a "business judgment" rule in evaluating the reasonableness of a tenant's reasons for withholding consent. Specifically, the court explained that a tenant must put forth "valid business reasons for its decision." *Id.* at 463 (citing *Leggett of Virginia Inc. v. Crown Amer. Corp.*, No. 94-0040-D, 1995 U.S. Dist. Lexis 6536 (W.D. Va. March 8, 1995)). When evaluating whether reasons asserted by a tenant are "valid business reasons," the court will defer to the tenant's prior experiences in the industry as a basis for determining how it reasonably believes the landlord's alterations will affect the tenant's business and customers.

When evaluating whether to withhold consent, a tenant need not perform studies or hire experts to determine whether the proposed alteration(s) by the landlord will indeed result in adverse impact(s) to its business. Instead,

the tenant may draw from its prior experiences with issues such as those resulting from the landlord's proposal, e.g., reduction in parking or loss of visibility. Further, the tenant's refusal to grant consent will be examined from the time such refusal is made,

Loss of visibility is an acceptable reason to deny consent.

"not post hoc on the basis of studies conducted and data collected by the parties subsequently" for the purposes of litigation, although "[t]hose studies may be relevant with respect to other issues presented." *Id.* at 463.

The deference given to the tenant's concerns presents a difficult burden for the landlord to overcome. This is evidenced by the *Safeway* court holding, "even if post hoc studies did not support Safeway's concerns or tended to show that those concerns were unfounded or of doubtful validity, it does not necessarily follow that the concerns were therefore an unreasonable basis on which to refuse consent." *Id.* Expert testimony and post hoc studies of existing site conditions are by no means irrelevant in these cases. Such testimony and studies can be utilized for other issues presented in the case, "including the likely consequences of the closure to the store as they pertain to the remedy question." *Id.*

Safeway proffered several arguments, including modification of the parking arrangement and loss of visibility, to buttress its position that withholding of consent was reasonable under the circumstances. The court's analysis as to these individual reasons for withholding consent are worth exploring because they are probably the most common reasons for withholding consent. In addition, these factors play a key role in

negotiating shopping center leases and culminate in bargained-for covenants within a lease whereby a landlord is required to obtain the consent of its tenant prior to altering the premises.

The number and location of parking spaces are very important to a shopping center tenant. In *Safeway*, the landlord's proposal would alter the parking configuration by eliminating a surface parking lot, leaving Safeway with only underground parking for its customers. Safeway withheld consent on the ground that this change in parking would deter customers from its store because, in past experiences at other stores, Safeway had determined its customers did not perceive underground parking to be as safe or convenient as surface parking. Safeway did not, prior to denying consent, conduct any parking studies, hire a traffic engineer or take site-specific customer surveys concerning the landlord's proposal.

Relying on the tenant's "business judgment," the court held that "Safeway's reliance on its experience, without undertaking any study, cannot be said to be unreasonable given the Restatement standard. Safeway's concerns in this regard cannot be said to be without significance or based on mere caprice or whim or personal prejudice." *Id.* at 465. In fact, the court took its analysis one step further by referencing studies performed for trial that concluded that urban grocery store customers were indeed receptive to underground parking. Safeway even conceded that underground parking at a nearby Safeway store functioned effectively and was accepted by its customers. Nevertheless, in the court's view, this did not render unreasonable Safeway's decision to deny consent, and the court found in favor of the tenant on the parking issue.

When evaluating whether visibility was a valid business reason for withholding consent, the court in *Safeway* relied on *K-Mart Corp. v. Oriental Plaza Inc.*, 694 F. Supp. 1010 (D.P.R. 1988), *aff'd*, 875 F.2d 907 (1st Cir. 1989). The *K-Mart* court applied the same section of the Restatement as did the *Safeway* court. In *K-Mart*, the court upheld the tenant's argument that consent was reasonably withheld because the landlord's construction would impair visibility of K-Mart's building and signage.

Loss of visibility

Examples of valid business reasons recognized in *K-Mart* for withholding consent based on loss of visibility are the inability to identify the store from the local roadways, the reduction that the loss of visibility would have on impulse shopping and the negative impact loss of visibility would have on the established street presence of the store. K-Mart's belief that these factors would reduce sales was more than reasonable in the court's view, noting that "the decision to enter a shopping center is difficult enough without removing the major incentive, the sight of the K-Mart." *Id.* at 1015.

The court further acknowledged K-Mart's desire to maintain its goodwill through uniformity of its stores, which the visual obstruction would essentially tarnish. The court in *K-Mart* stressed the ability to protect "the kind of surroundings K-Mart bargains for when opening stores" and recognized that "without the high visibility that this K-Mart store once possessed, impulse sales will suffer." *Id.*

On the other hand, the facts in *Safeway* led to the conclusion that Safeway would not suffer a loss of visibility justifying the withholding

of consent. This conclusion was primarily due to the fact that Safeway, even before the landlord's proposed construction, had no visibility from the street and therefore lacked the street presence at issue in *K-Mart*. In addition, the only Safeway sign was located on the interior of the building, and the parking structure that already existed blocked all views from the street of the entrance to the shopping plaza.

Although the court did not accept Safeway's loss-of-visibility argument, it did acknowledge that an obstruction to a storefront's visibility typically would be a reasonable ground for withholding consent. As stated by the court, "placing a building in the parking lot of a store would normally have the effect of blocking the view of the store from the street, thereby reducing, at least to some extent, the general visibility of the store." *Safeway*, 261 F. Supp. 2d at 464. In distinguishing *Safeway* from *K-Mart*, the court conceded that the shopping plaza in *Safeway* was not the normal suburban-type center where a grocery store fronts an open parking lot in view of passing traffic. Therefore, if a tenant has established a street presence within a shopping center, withholding consent will be reasonable if the tenant in its own business judgment believes the proposed alteration by the landlord would have a negative impact on its street presence.

'Business judgment' rule

The *Safeway* and *K-Mart* cases demonstrate that a tenant possessing a right of consent to the landlord's additional development can have broad latitude to withhold consent based on

objective reasons in consideration of the tenant's business judgment. By developing a "business judgment" rule for determining whether a tenant acted reasonably in withholding consent, the courts have established a trend that favors the ability of tenants to maintain their business at the expense of a

landlord's ability to maximize its profits by expanding the premises.

These decisions easily could have resulted in a rule mandating that a tenant come forth with factual proofs demonstrating the adverse impacts resulting from landlord's proposal.

Clearly, courts have taken into consideration that businesses engage in substantial due diligence concerning issues such as parking and visibility before choosing a store location. Furthermore, a business's desire to maintain its goodwill by having uniformity among its store locations will be deemed significant.

Finally, these decisions establishing a "business judgment" rule reflect that a tenant's decision to withhold consent should not be judged in a vacuum. Allowing a tenant to draw from past experiences at different locations indicates a willingness to account for future considerations and events, which are sometimes unknown, to be factored into the equation of determining whether to withhold consent. **NLJ**

Tenants with right of consent have broad latitude to refuse.

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