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Spring 1998

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RECORD STORE USE AND EXCLUSIVE CLAUSES

As the definition of "record store" changes, use and exclusive clauses require careful drafting.

EMANUEL B. HALPER

Record stores predate the modern shopping center era.¹ They could be found in neighborhood shopping districts as well as in downtown central business districts.

Pre-World War II record stores did not specialize in 33 r.p.m. (rotations per minute) long-playing vinyl records. Until the end of World War II, phonograph records, ten inches wide, spun at 78 r.p.m. and produced about three minutes of (often scratchy) music. Records were sold by specialized record stores, by small operators, and by general merchandisers like the F.W. Woolworth Co. variety store chain.

In that era, a small drugstore in Sacramento, California called Tower Cut Rate Drug Store sold 78 r.p.m. records from a small part of its sales floor. The owner was the father of Russell Solomon, founder of Tower Records. Another specialized merchant who diverted space from his core merchandise lines and allocated it to records then was Sam Gutowitz (nicknamed Goody).

Sam diverted space and started a record department in his New York City toy and novelty stores. After World War II, he was quick to recognize the potential of long playing records (LPs) and high-fidelity audio equipment. The first Sam Goody's store devoted principally to records, with a large (by that time's standard) inventory

and a reputation for low prices, rapidly gained acceptance. Sam opened many more stores, and Goody's became one of the chain store record business' pioneers.

Although they were relatively small by today's standards, Goody's and other early record stores carried many products other than records. Some record stores carried a wide array of related merchandise, including amplifiers, tuners, speakers, and turntables. Thus, early on they competed directly with sound equipment stores and later with consumer electronics stores. In shopping centers, the duplication created potential conflicts between the record stores' use clauses and the other tenants' exclusive clauses.

In the 1950s and 1960s, shopping center landlords tried to limit record store product lines and, if possible, to completely prohibit record stores from selling sound equipment. Record store operators, of course, resisted demands for such restrictions, and landlords who wanted to lease space to a sound equipment store and to a record store had to learn some fancy footwork.

For two reasons, most of the compromise leases tilted toward the record stores.

■ Relatively few sound equipment stores in the 1950s and 1960s cared about shopping center locations. Most were comfortable in downtowns.

■ The landlords preferred record store tenants. Records appealed to the masses and attracted the kind of consumers who were apt to browse through the shopping center before or after visiting the record store. Sound equipment stores attracted relatively

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few customers, most of whom were focused on a single product.

FROM VINYL TO COMPACT DISC

Record stores changed considerably over the years, responding to technological change. In the 1950s, 33 r.p.m. LP records supplanted 78 r.p.m. records. LPs were able to withstand the early challenge of audio cassettes, but were supplanted by CDs (compact discs) in the mid 1980s.

An independent force for change was the rise of large, skillfully-marketed record stores carrying huge inventories that were dubbed record superstores. By 1990, nearly one-half of Tower Records units contained at least 10,000 square feet of gross leasable area, and one store totalled 39,000 square feet of gross leasable area. A British transplant, HMV, weighed in with a unit that contained 40,000 square feet.

Record superstores achieved impressive sales volumes. They sold rock music to younger customers, and were still able to tempt classical music lovers with wide selections and good prices. To draw crowds, they offered in-store performances by popular entertainers and introduced new technology to allow customers to listen to selections before purchasing. Most interesting to the lease drafter, their merchandise mix differs from that of the 1960s stores. Big record stores now concentrate on CDs, audio cassettes, video cassettes, and laser discs. They also carry blank audio cassettes, blank video cassettes, small listening devices, and audio accessories. Although there is nothing but a use clause to stop them from adding or subtracting product lines, they are no longer interested in sound equipment. On the other hand, record stores may now start to conflict with video stores' exclusive clauses. Because the record superstores tend to be much larger than video stores, record store operators who have the right to rent videos and who choose to underprice the video stores can overwhelm them.

Landlords who want both types of tenants can reconcile a video store request for an exclusive clause limitation on record stores sales of video cassettes by focusing on the essential distinction between the two types of businesses.

The rise of record superstores compelled landlords to redraft exclusive clauses.

A record super store's principal interest in video cassettes is to sell them, and the video store's principal interest in video cassettes is to lease them. Consequently, a record store landlord should make sure that the use clause should restrict (or at least limit) video rentals.

Conversely, a video store landlord should try to limit video sales if he or she wants to attract a record store too.

Video cassette sales by a video store co-tenant might not be overwhelming to a record store now. However, DVD technology might subject video stores to direct attack by aggressive record store merchandisers.

RECORD STORE EXCLUSIVE CLAUSES

For more than two decades, shopping center landlords tilted with record store tenants, trying to define which other stores would or would not be allowed to sell records in the shopping center. Although record store merchants were unable to reserve the entire market to themselves, they were able to limit (with a few exceptions) the sale of records by all other stores.

Record stores did not have the bargaining power to bar record sales from department stores, variety stores, supermarkets, or drug stores. Nobody was about to tell a department store executive that the store had to drop its record department. Variety stores could not be convinced to forego the right to sell records. Supermarkets were growing in size and expanding rapidly in nonfood areas, and the more aggressive supermarket chains fought hard to extend their use rights to embrace general merchandise. Although some drugstores tolerated restrictions, those that had record departments insisted on keeping them. (Not entirely coincidentally, record store mogul, Russ Solomon, founder of Tower Records, started his career in the record department of his father's drugstore.)

Although they did not have enough clout to impose their will on big stores, record store merchants fought to stop other small stores of the shopping center from selling records. They were particularly concerned about the competitive threat of bookstores.

Finally, owners of small record stores that weren't able to convince their landlords to agree to a broad restriction against the sale of their core products by other stores attempted to exclude any other record store from becoming a co-tenant in the shopping center.

Changing Lease Clause Needs

Then, suddenly, in the mid-1980s, most existing record store exclusive clauses became obsolete. Record shops lost interest in selling records. The LP record and the cassette tape were replaced by the compact disk. Record stores loved the new compact disks; record manufacturers were cleaning up; and most of the public was enthusiastic.

Paradoxically, a restriction against the presence of another record store in the shopping center remained potentially useful to record store owners. Those restrictions could still be enforceable because many stores that used to sell records, and that now concentrated on compact discs, continued to call themselves "record stores," and many people still call them record stores (although they're also referred to as music stores).²

It is unlikely, however, that courts will decide that an old restriction against the sale of records also bars the sale of compact discs. People refer to records and compact discs by different names, and records and compact discs function differently from each other.

A record store tenant would have a better chance of enforcing an old restriction if the exclusive clause extends that restriction to all forms of recorded music and speech. Unfortunately, only a handful of these old leases extend the product restriction to all forms of recorded music and speech.

Potential Pitfalls

Record store lease negotiators of the 1990s should still be concerned about exclusive clauses. Except for medium and larger regional shopping centers, those who negotiate for a record store seeking tenancy in a shopping center should propose that all other record stores be excluded from the shopping center.

The dwindling number of smaller record store operators should be more concerned than record superstore operators about the effects

Landlords should be wary of exemption clauses; they must be carefully written.

of direct competition. When both the record store and the shopping center are small, their potential market is also small. These operators obviously should try to avoid significant competition from large co-tenants. Competition from a compact disc or audio cassette shelf or two in another store is unlikely to hurt even a small record store. However, small stores may be unable to handle competition from (say) a consumer electronics

store that carries a substantial recorded music collection.

A consumer electronics chain store is unlikely to agree to a small record store's restriction against the sale of compact discs, audio cassettes, and laser discs. However, if the market is too small to support both kinds of stores, a record store operator would be foolish to sign a lease without the exclusion. At minimum, the record store's restriction proposal will bring the problem to the surface and might force the landlord to decide between the benefit of a current record store lease and the prospect of a consumer electronics store lease in the future.

Contemporary small and medium-sized record stores that negotiate for space in neighborhood and community shopping centers should also propose that all other stores of the center (except for a list of exempt stores) be barred from selling compact discs, records, cassettes and other forms of recorded music or speech. The exempt stores probably will have to include department stores, variety stores, supermarkets, and drugstores.

Exempt the Competitor, Not Its Premises

Conversely, other exemption clauses provide that the premises in which the (for example) department stores, variety stores, supermarkets, and drugstores are located are exempt. That's different and dangerous to a record store operator's piggy bank and mental health. Here's why. Since the use clauses of these tenants' leases tend to be very liberal, some of these tenants have the right to convert the premises into smaller retail units with separate entrances to the common area. If (for example) a department store tenant realizes that it's losing money in the shopping center,

one logical path for it to take in an effort to stop the bleeding is to convert the entire premises for use as a category killer. It also might decide that the only merchandise categories it chooses to sell are C.D.s, audio cassettes, laser disks and video tapes. Carving smaller spaces from the premises is another logical path for an anxiety stricken department store executive. However, he or she should not have the power to destroy a small record store operator's business by deciding to lease one

of the carved out stores for use as a record store. ■

NOTES

¹Background information for this article was gathered from the following sources: Gail Buchalter, "Profiting Well Is the Best Revenge," *Forbes* (Oct. 22, 1990); Mark Maremont and Julie Fingeresh, "The Brit Invasion That Could Rock Tower Records," *Business Week*, p. 41, (December 3, 1990); "The Marketing of Classical Records," *American Record Guide*, p. 7 (July-August, 1988); and Peter Newcomb, "I Heard it at the Record Store," *Forbes*, p. 88 (July 8, 1991).

²Like most consumers, this article continues to refer to stores selling the many forms of recorded music and speech as "record stores."