REAL ESTATE

REVIEW

Summer 1998

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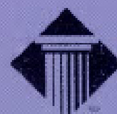

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SPORTING GOODS STORES' USE AND EXCLUSIVE CLAUSES[1]

EMANUEL B. HALPER

Sporting goods stores aren't creatures of the 1990s. They've been around longer than you or I and probably even longer than the editor of this publication. Before the modern shopping center era, they were found in the downtown central business district and in neighborhood shopping districts.

EARLY HISTORY

These early sporting goods stores didn't have the market to themselves. Department stores, variety stores and even candy stores[2] provided a measure of competition. Among the competitors, some department stores had large sporting goods departments and competed vigorously for consumers' favors. However, the variety stores and neighborhood candy stores weren't much of a threat. Before the vast changes that occurred after World War II, they carried only low-end and mundane sports equipment.

Only the sporting goods stores and department stores carried large quantities of the good stuff. Not only did they carry bats, balls, shoulder pads, and punching bags, they also sold sports clothing and uniforms.

The pre-shopping center sporting goods stores were usually small stores. Compared to contemporary sports superstores, these stores were tiny. Only occasionally would one find a large sporting goods store in some downtowns.

Entry Into Shopping Centers

Early shopping center developers valued sporting goods stores as prospective tenants, and they tried to accommodate sporting goods merchants' special needs. Back then, it was much harder for a landlord to find a sporting goods store tenant. Relatively few sporting goods stores existed, and sporting goods proprietors did not spring aboard the shopping center bandwagon at the outset. From the landlord's point of view, getting a sporting goods store tenant was a coup that made the shopping center special.

Like their counterparts in the downtowns, the sporting goods stores that joined the shopping center movement tended to be small stores. Like most small stores, they demanded exclusive clauses, arguing (with considerable merit) that small stores were more vulnerable to predatory competition than large stores, and that a small or medium-sized shopping center couldn't support more than one sporting goods store.

Most of these early shopping center sporting goods merchants were independent operators because few sporting goods chains had yet developed. Consequently, the results of negotiations about sporting goods store exclusive clauses varied considerably from lease to lease.

Attempts to Solve Tenant Conflicts

Neither the early shopping center developers nor their early sporting goods tenants had any experience on which to base use and exclusive clause negotiations. The slavish regard of their attor-

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neys for clauses drafted by others led them to copy use and exclusive clauses of the old downtown central business district leases.

Unfortunately, use and exclusive lease clauses for downtowns and urban neighborhood shopping districts weren't good models for shopping center leases. Downtown and urban neighborhood shopping district landlords tend to be owners of a single building, possibly a few buildings. A downtown CBD office building owner was perfectly content to give the retail store on the building's grade floor the exclusive right to sell sporting goods in the building. That store was probably the only store in the building.

Lease clauses for downtown neighborhoods were poor models for shopping center leases.

Shopping center attorneys who were content to copy exclusive clauses from leases for sporting goods stores located in downtowns accepted the principle that the sporting goods store should have the exclusive right to sell sporting goods in the shopping center. Those provisions, however, could expose a shopping center landlord to many difficulties. They created the possibility of a conflict between the sporting goods store's exclusive clause and the use clauses in the leases with department stores, five- and ten-cent stores, variety stores, and toy stores.

The more foresighted attorneys and landlords recognized that some kind of sporting goods was sold by many different stores in the center and that they had to modify the language of the sporting goods store's exclusive clause. One approach was to provide a list of other shopping center stores that would be exempt from the restriction. Department stores, five- and ten-cent stores, variety stores, and toy stores were the most prominent beneficiaries of the exemptions.

Other landlord attorneys revised the clauses completely so that the exclusive clause would protect the tenant without being potentially destructive to the landlord. One such revision provided that the tenant's store would be the only store of the shopping center that could be used *principally* for the sale of sporting goods. All other stores in the shopping center would be permitted to carry sporting goods as long as those stores were not used *principally* for the sale of sporting goods.

The kind of exclusive clause the early negotiators ultimately accepted had the potential to make a big difference. Merchants with weak exclusive clauses became susceptible to unexpected competition; landlords who had been lax negotiators lost significant opportunities. More about that below.

New Competitors Arrive on the Scene

As time passed, the retail sporting goods world began to change. Both participatory and spectator sports increased their popular appeal. Older stores expanded and large newer stores were opened. General merchandise stores and new kinds of stores expanded or began to carry merchandise that could be classified as sporting goods.

The new competitors included instant pickup catalog stores and toy and game superstores. These new stores leased very large spaces — often huge free-standing buildings (big boxes). Of course, landlords found that tenants that lease large spaces pay lots of rent and are highly desirable. The new stores were efficient and low-priced competitors. A customer could walk into an instant pickup catalog store (among them Service Merchandise and Consumer Distributing), select a product from the catalog, and take it home right away. That was quite a difference from buying from the Wards or Sears catalog stores and waiting for the stuff to be shipped from a warehouse. The old sporting goods stores also felt the competition of toy and game supermarkets. These stores weren't anything like the early shopping center toy stores. They were massive, well-organized, and efficient; and their price policy was very competitive. They demanded the right to sell anything that might be of use to a child, and they had little patience for landlords who were tied down by restrictive use clauses.

In time, food supermarkets also entered the fray. As they got bigger, they materially increased the percentage of space devoted to nonfood items — some dropping the word food from their designations. Supermarket was a broader term. They also demanded more expansive use clauses. They wanted the right to sell anything; and anything included sporting goods. Thus, supermarkets gained the right to sell sporting goods.

Conficts were arising for existing shopping center landlords with loosely drafted leases. These landlords could not afford to agree to the demands made by their new tenants without

examining the center's many existing leases and their use clauses. Landlords who were about to develop new shopping centers didn't need to fret over existing leases. They were able to organize leasing programs to adapt to the fact that instant pickup catalog stores, toy and game superstores, and supermarkets needed liberal use clauses. They could negotiate freely with new sporting goods store tenants.

Existing shopping center landlords with loosely drafted leases had serious conflicts.

On the other hand, when landlords of existing shopping centers wanted to add a new big box, instant pickup catalog store or toy and game superstore, they had to confront small store sporting goods merchants' leases that included exclusive clauses that could abort the new deal. The chance of making the deal, and thereby materially increasing the landlord's rent roll, depended (at least in part) on the sporting goods lease. If the sporting goods store lease didn't provide for an exclusive, no problem. If the sporting goods store lease contained a broad exclusive, the sporting goods store merchant had the power to kill the deal. A clause that prohibited all but a few exempt general merchandise tenants from selling sporting goods was a boon for the sporting goods merchant. These clauses exempted department stores and variety stores, but the instant pickup catalog stores and toy superstores couldn't qualify either as department stores or variety stores.

Exclusive clauses that barred any other sporting goods store from the shopping center were far less troublesome to the landlord. Most prospective new general merchandise tenants, even those who professed antipathy to any use restriction, were willing to agree not to violate a restriction against converting their operation to a sporting goods store.

Superstores Move Into The Malls

At the same time that the new, rapidly expanding, and prosperous instant pickup catalog stores and game superstores were trying to shoehorn their way into existing shopping centers, supermarket chains were undergoing changes that would help open the doors. The supermarkets were anxious to rid themselves of lease obligations for smaller and unprofitable units. While the catalog stores and toy and game superstores were busy looking for new sites, supermarket real estate departments were busy looking for potential assignees or sublessees for their inadequate units. Inevitably, the potential assignors and assignees met and made deals. The deals were possible because landlords had negotiated supermarket leases laxly, a failure that made them vulnerable to unexpected and adverse consequences.

In 1958, few landlords had the courage to pick a fight about use clauses with potential supermarket tenants. Besides, who in 1958 thought that a grocer might decide to sell baseball gloves? As indicated above, many supermarket tenants could boast of a use clause that permitted the premises to be used for *any legal purpose. Any legal purpose* includes use as an instant pickup catalog store or a toy and game superstore. It also includes activity as a sporting goods store. So the 1970s and 1980s landlords were stuck with loosely drafted 1950s supermarket leases. Supermarkets assigned their leaseholds to instant pickup catalog stores and toy and game superstores. Only now were landlords realizing that they might have been able to avoid the sale of a defunct or struggling food supermarket's leasehold if they had been less accommodating at lease negotiation time and had insisted on assignment restrictions. Tougher supermarket use and alterations clauses might have prevented the leasehold assignees from using the supermarket premises to conduct a business other than a food supermarket business.

Most frustrating from the landlord's point of view was the realization that the leasehold assignee might be free to violate the exclusive clauses of other tenants' leases. When the supermarket lease had priority over the other tenants' leases, the supermarket's assignee or sublessee was free to violate the other store's exclusive clauses. The landlord was contractually bound to enforce the other tenants' exclusive clauses but was unable to prevent the assignee or sublessee from violating the use clause of the other tenants.

A shopping center landlord, presented with a supermarket's conversion to an instant pickup catalog store or toy and game superstore, might worry about financial loses even in the absence of conflict between tenants because of a sporting good store leases exclusive. Would the new merchant be a vigorous competitor? Would the

newcomer wipe out existing tenants like the sporting goods store merchant? The worst part of this nightmare for some landlords was that they would derive no benefit from the food supermarkets conversion to a new and (probably) more profitable use.

In fact, despite their large sales floors and aggressive price policies, the instant pickup catalog stores and toy super stores didn't overwhelm all small sporting goods merchants. The big stores' merchandise mix was too diverse to eliminate an aggressive small store competitor with a highly focused merchandise mix.

Landlords who were developing new shopping centers were not troubled by the growth of the instant pickup catalog store or the toy and game superstore. They were delighted with the prospect of leasing space to two new kinds of big box retailers. True, some small store merchants perceived those big box retailers as predators, but they recognized that the landlords would be delighted to make deals with the new competitors, even if that meant they had to forego the privilege of leasing space to small sporting goods store merchants.

Sports superstores are category killers!

The Growth of the Sporting Goods Market

One change of the 1970s and 1980s was a great benefit to shopping center landlords and tenants alike. America's flourishing economy was leading to a further (considerable) increase in both leisure time and disposable income. People wanted activity. People wanted recreation. Shopping itself emerged as one of the world's most popular forms of recreation — especially for women. My wife and daughter view shopping as an invigorating sport they love to play together. Both men and women also became involved in other sports. They played and they watched others play. Adults took to golf and tennis. They ran, walked, and swam; they played softball, baseball, basketball, football, and soccer. Little Leagues attracted everybody's kids. When currently popular sports didn't fill the bill, America imported others. Soccer and volleyball boomed.

Not everybody could participate in sports, but everybody could enjoy watching them. A new generation of men, raised in front of cathode ray tubes, realized that they could not be separated from Sunday afternoon or Monday night football. Baseball, basketball and hockey were telecast in major markets. Men (and women) watched golf, tennis, boxing, wrestling, and racing as never before.

Harnessing this potential market promised marvelous benefits to merchants and shopping center landlords. Sporting goods sales grew in the 1980s, and the sales growth spurred the inauguration of more sporting goods chains. Sportmart, an early large store competitor, started in 1971 and by 1992 boasted of 25 stores. Sports Authority was a relative latecomer opening its first huge store in 1987.

Shopping center sporting goods stores began to grow in size. Some pre-1990s stores spurted to 10,000 square feet of floor area. Soon, the sporting goods superstore was born, and today these stores range from 25,000 square feet of floor area to monster stores with about 80,000 square feet of floor area, offering sports merchandise. Some of the larger units feature sports demonstration facilities like a basketball half-court, a batting cage, and practice areas for tennis and golf. Consumers can try out the products before they buy them.

Sports superstores are category killers. There is great depth within merchandise categories, and some of these categories are extremely profitable. One sporting goods chain stated that 27% of its space was devoted to sports apparel, 21.8% to athletic footwear, and 51.2% to hard sporting goods. Its stores included five specialized departments: sportswear and athletic apparel, athletic footwear, participation (club) equipment, fitness equipment, and field and stream and outdoor equipment. Sports apparel is reported to comprise 50% of Sports Authority's product mix. Super Sports USA's categories included sports videos; backyard accessories; boating, fishing and camping equipment; exercise equipment; hunting knives, sport bags and sports apparel. Men's wear, women's wear, and sports shoes comprise about one-half of the product mix.

Today's product mix isn't necessarily tomorrow's product mix. New products are being added, and others dropped.

USE CLAUSES FOR SPORTS SUPERSTORE LEASES

A sports superstore tenant should try to negotiate a use clause that would allow the premises to be used for almost any legal purpose. The ten-

ant has committed itself to paying rent on more than 30,000 square feet of gross leasable area for more than ten years and it must worry about selling enough merchandise to pay the rent and make a profit.

Their landlords must engage in delicate balancing acts. On the one hand, sports superstores are potential competitors for a wide range of tenants that might be, and customarily have been, the beneficiaries of their own exclusive clauses. But the huge size and wide assortment of merchandise categories in sports superstores makes them big and strong enough to make tough negotiating demands.

> Lease negotiations between category killers and existing centers are the most difficult.

The most difficult lease negotiations are those between category killers and existing shopping centers. These negotiations offer more problems than negotiations for space in new centers to be developed. In an existing shopping center, the owner might be forced to say no to the sports superstore's request for a liberal use clause or to negotiate with existing tenants for lease amendments to accommodate the sports superstore merchant's desire and need for a liberal use clause.

Not only are there potential conflicts with the products that the new sports superstore and the existing tenants may carry today, there are conflicts about tomorrow's products. Category killer chains want use clauses that anticipate changes in merchandise mix. A use clause that is broad enough to allow the superstore to make radical changes in its merchandise mix is broad enough to cause conflicts with other tenants' exclusive clauses.

Executing a lease with a sports superstore may turn out to be completely impossible if the existing shopping center has a small sporting goods store among its tenants. If that small store's lease includes an exclusive clause, it's highly likely that the small store tenant will use the power bestowed by that exclusive clause to kill the sports superstore deal.

If the shopping center does not include a small sporting goods store tenant, negotiation to reconcile the sports superstore's use clause with the exclusive clauses of the other tenants' leases is a more likely scenario. Adding a huge new category killer to the center will probably draw more traffic to the center, extend the range and scope of its geographic market and increase everyone's sales volume.

EXCLUSIVE CLAUSES FOR SPORTS SUPERSTORE LEASES

What kind of exclusive clause should landlords concede to the sports superstore?

Certainly, landlords can't agree to limit the sales of sporting goods to one merchant — even a merchant that leases a monstrous store. Department stores still continue to sell sporting goods. The products sold in sports superstores are also sold by instant pickup catalog stores, toy and game superstores, drugstores, food supermarkets, sports shoe stores, sports apparel stores, and small specialized sports equipment stores. Sports superstores should be willing to live with competition from small stores that specialize in one or a few of their core categories.

Caught between the devil and the deep blue sea, landlords cannot absolutely refuse a sports superstore's request for an exclusive, but they can't grant the superstore the exclusive right to sell sporting goods in the entire shopping center.

A compromise clause that makes good sense for all parties would provide that the sports superstore will be the only store in the shopping center to be *principally* used for the sale of sporting goods, and the only sporting goods store in the shopping center. The agreement could exempt specific kinds of stores from restrictions: small sports shoe stores, sports apparel stores; and small stores specializing in a single, or a few, sports activities (such as hunting and fishing specialists).

After the landlord executes a sports superstore lease, he or she must be careful to avoid conflicts between the sports superstore lease and new leases negotiated thereafter. A landlord should be especially sensitive to potential overlaps between sporting goods store leases and other leases under certain circumstances, and act as follows:

- When the landlord grants a restrictive covenant to a clothing store lease against the sale of clothing, it should insist on an exception to permit the sports superstore to sell its usual clothing lines.
- When the landlord agrees in a shoe store lease to prohibit the sale of shoes, he or she should

carve out an exception for the normal shoe lines of the sporting goods store.

■ If the sporting goods store tenant has insisted on a restriction against other stores selling sporting goods, the landlord must insist that clothing and shoe stores have the right to sell clothing and shoes that could be considered sporting goods under a broad definition of that term.

What great moral principles can you derive from paying so much attention to sporting good stores and their use and exclusive clauses? No great moral principles are involved, but careful attention might help you avoid losing a lot of sleep and (maybe worse) a lot of money. ■

ENDNOTES

[1]Some of the facts in this article are taken from the following source Debra Hazel, "Are Sporting Goods Next? Superstores Challenge Small Operators," 69 *Chain Store Age Executive* (June 1993) pp.27, 28; Jennifer Pellet, KMart's Sporting Proposition, 33 *Discount Merchandiser* (February 1993)p. 64; "Sportsmart's Ambitious Plans," 32 *Discount Merchandiser* (November 1992)pp. 22, 23.

[2]This reference to candy stores might confuse you. The pre-shopping center era neighborhood candy store was not at all like today's vastly different candy stores. Today's stationery stores play a role something like the pre-shopping center era neighborhood candy store. Certainly, they sell candy, but they don't focus on boxed chocolates. Pre-shopping center era neighborhood candy stores featured soda fountains, cheap candy, newspapers, magazines, and ice cream. They also carried school supplies, cheap sports equipment, and cheap games. Best of all, they were social centers where pre-teens and teenagers gathered.