Law of the Land - Real Estate Litigation Newsletter

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This newsletter is meant to keep readers informed about current property law issues in Massachusetts and elsewhere. A team of Goulston & Storrs real estate litigators reports on recent cases and important news relevant to the real estate industry.

TRENDING NOW

The Pandemic and the Future of Faneuil Hall Marketplace

Last month, Ashkenazy Acquisition Corp. ("Ashkenazy") was served with a $2.1 million default notice for unpaid Payment In Lieu of Tax (PILOT) to the City of Boston in connection with its lease of the historic Faneuil Hall Marketplace. The City of Boston owns Faneuil Hall and granted Ashkenazy a long-term lease to operate the iconic property, including the right to collect all rents from the variety of vendors and merchants who operate out of the Marketplace. Ashkenazy pays only $10 per year in rent under the 99-year lease it acquired in 1975, but owes annual PILOT payments that are calculated based on a percentage of the prior year's revenues.

Like nearly every other retail landlord in the country, Ashkenazy has been hit with massive financial losses as a result of the COVID-19 pandemic. This has left Ashkenazy with little-to-no incoming revenue from Faneuil Hall to cover the PILOT payment that is based upon last year's much higher revenues. Simultaneously, Ashkenazy has been the focus of vocal disapproval from Faneuil Hall tenants who have alleged that Ashkenazy has failed to reasonably negotiate rent relief or properly maintain and clean the Marketplace during the pandemic. In response, Ashkenazy has clarified that it paused rent collections on the many mom-and-pop shops that operate at Faneuil Hall (although it has not forgiven all the past-due rent that is still accumulating) and have been keeping up with routine maintenance. Additionally, less than a week after receiving the default notice, Ashkenazy paid the full amount due.

While the pressure and strain of the COVID-19 pandemic's economic pressure continue, Faneuil Hall Marketplace perfectly encapsulates the challenging push-pull dynamic that exists between local governments who are stretched to maintain services with significantly reduced tax income; landlords like Ashkenazy, who must meet their tax and loan obligations while facing reductions in rental income of 80% or more; and the local city-center retail tenants who face dire financial situations, with rent accumulating while sales have remained devastatingly low for nearly a year.

CASE OF NOTE

Simon Says: Stores Stay Open

Abercrombie and Fitch Stores, Inc. v. Simon Property Group, L.P., 2020 WL 6948335 (Ind. Ct. App. Case No. 20A-CT-1092, Nov. 25, 2020)

A recent decision of the Indiana Court of Appeals shows the pendulum of commercial landlord and tenant law shifting further in favor of landlords.[1] Beginning in February of 2019, Abercrombie and Fitch Stores, Inc. ("Abercrombie") began negotiating one- to two-year extensions of the leases on its portfolio of 53 stores located in Simon Property Group, L.P. ("Simon") malls, all of which were set to expire on or before January 31, 2020. On January 14, 2020, an Abercrombie representative sent an email agreeing to package terms for the portfolio lease amendments (as well as a resolution regarding a percentage rent dispute) and stating those terms were the parties' final positions. The parties then began drafting amendments for each of the applicable leases, conforming them to deal terms. As of February 1, 2020, Abercrombie had already begun paying the reduced rent amount called for under the lease amendments.

When the COVID-19 pandemic hit in early March, the parties were midway through signing up the lease amendments. On Friday, March 13, 2020, Abercrombie sent executed versions of 42 of the agreements. On Monday, March 16, 2020, Abercrombie closed all of its stores in Simon malls, and on March 18, 2020, Abercrombie sent a letter purporting to retract its signature on the signed lease amendments. Between March 17-26, Simon countersigned all 42 lease amendments. Simon filed suit in short order seeking a declaratory judgment that the amendments were enforceable. Abercrombie's threat to permanently close all its stores also prompted Simon to seek a preliminary injunction to reopen the stores.

In opposing the preliminary injunction, Abercrombie argued that it could not be bound by the lease amendments, and further that would suffer losses of $500,000 per week if forced to reopen all stores. Abercrombie also argued that Simon's alleged "slippery slope" harm was speculative, *i.e.* that if Simon allowed Abercrombie to close, then other tenants will follow suit and unilaterally break their leases early. In support of its position, Abercrombie provided evidence that between 2016 and 2018 Abercrombie closed 33 of its stores in Simon-owned malls, during which time Simon was still making significant profits. In contrast, Simon relied on expert testimony from a Professor at Indiana University's Business School, asserting that the closure of well-known stores like Abercrombie would have a cascade effect on both customer confidence and other mall tenants, causing reduced customer demand and making it significantly harder to attract and retain other tenants, which he argued would cause irreparable harm that exceeds any losses that Simon could recover from Abercrombie in the form of unpaid rent.

The lower court in Indiana granted the preliminary injunction, holding that because Abercrombie as a whole is financially healthy, its admittedly significant financial harm is outweighed by the harm to Simon from depressed customer demand and the potential for other tenants to suddenly vacate or fail to renew their leases. However, the court required Simon to post a bond of $15,000,000 as security against Abercrombie's losses if Abercrombie prevails on the merits.

Abercrombie appealed the lower court decision granting the injunction. Preliminary injunctions are an extraordinary remedy that are designed to preserve the status quo while litigation proceeds;

therefore they are not typically granted and must be narrowly tailored. A party seeking a preliminary injunction must present an onerous standard, showing: (1) their remedies at law are inadequate and that irreparable harm will occur while the action is pending, (2) they have a likelihood of success on the case's merits (although in Indiana this only requires a showing that the movant has a "better than negligible" chance of succeeding on the merits), (3) the threatened harm outweighs the potential harm the injunction would pose to the non-moving party, and (4) the public interest would not be disserved by granting the injunction.

The Indiana Court of Appeals upheld the decision, deferring to the fact-finding of the trial court, in particular its evaluation of what constitutes the "status quo" here. The Court of Appeals agreed that "status quo" in this case was the period before COVID-19 because the preliminary injunction was designed to prohibit Abercrombie from using COVID-19 as an opening to permanently close its stores, not to force Abercrombie to immediately reopen in violation of government shutdown orders. The trial court and the Appeals Court were persuaded that the communications between the parties signaled their intent to be bound by the terms of the leases, which would require Abercrombie to stay open if permitted under government orders.

This case illustrates three key points for both landlords and tenants:

1. parties' intention to be bound by the terms of an agreement remains the hallmark of determining when and how business negotiations move from mere discussions to binding agreements;
2. the increasing trend of courts to issue injunctions to enforce continuous operating clauses against otherwise financially solvent retail tenants to prohibit efficient breaches of leases; and
3. the baseline expectation that courts will not renegotiate business terms for retail tenants even in the face of the unprecedented impacts of COVID-19

[1] This case, taken in the context of some recent Indiana and Washington state cases, reflects a growing willingness of landlords to require tenants to remain open.

Converting an Office Building to an Office Building?

A Goulston & Storrs real estate litigation team won a victory before the Massachusetts Land Court, saving the client two million dollars in development costs. A large development company (Developer) has undertaken a project to renovate and expand an office building in a Massachusetts city (City). The building was constructed in the 1950s as a steel plant, and converted to office use in the 1980s.

The City recently enacted a zoning bylaw that requires developers to make a housing linkage payment any time the developer builds new office space. The bylaw also requires that developers make a payment when they renovate a building to "accommodate" a use for which the building was not "originally" used. Citing this provision, the City's Building Commissioner charged Developer a

housing linkage payment for *both* its addition to the office building (which Developer did not oppose), as well as its renovation of the existing building (which Developer did oppose).

In support of its assessment of payment based on the renovation of the existing building, the Commissioner asserted that the building was originally constructed as a steel plant. The Commissioner, however, disregarded the fact that the building was converted to office use decades ago, and was not changing uses by virtue of our client's renovation now.

After an unsuccessful appeal to the City Board of Zoning Appeals, litigators Joel Antwi and Kevin O'Flaherty filed suit in the Land Court challenging the Zoning Board's decision. During discovery, the Goulston & Storrs team unearthed the legislative history associated with the at-issue zoning bylaw. That history demonstrated that the City Council flatly rejected legislative language that would allow a housing linkage payment to be assessed for a renovation where the renovation did not result in a change in use. In fact, the City Council amended the bylaw's draft language to *avoid* that outcome.

Our team moved for summary judgment arguing that the clear language of the zoning bylaw supported their interpretation that a renovation would have to change a building's use in order to trigger a housing linkage payment. They further argued that even if the statutory language was ambiguous, the legislative history demonstrated that the City Council rejected language that would operate in the way the Building Commissioner and Zoning Board suggested. Finally, Goulston & Storrs pointed out that any time a certain statutory construction would operate to reach an absurd result (such as punishing developers for adaptively reusing buildings), a court must consult the legislative history. Mr. Antwi presented an oral argument before the Land Court on these issues, and the Court issued an order rejecting the Commissioner's interpretation of the zoning bylaw, and vacating the Zoning Board's decision, saving our client the two million dollar payment that would have resulted from the application of the City's interpretation.

CLIENT WINS

Since October, Goulston & Storrs real estate litigators have secured two wins on behalf of our clients against disruptive neighbors/tenants. In both cases, abutters who live or work next to ground-up, major development projects attempted to enjoin construction of those projects mid-stream. Those tenants and abutters rushed to court in an attempt to impose major cost and inconvenience on developers; in both cases, Goulston & Storrs successfully defeated those motions and allowed developments to move forward.

If you have a real estate litigation question or business concern, we invite you to reach out directly to any member of our Real Estate Litigation Group.

DISCLAIMER: This advisory should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer concerning your situation and any specific legal questions you may have.