

Discount-Hawkins Negotiation

Confidential Information for HAWKINS

The Merrimack Mills was a thriving textile factory in the town of Northport, Massachusetts, and is the site of a proposed shopping mall planned by Hawkins Development. Hawkins is a small, but successful development company founded 20 years ago. Since then, it has developed several commercial and mixed use projects in the region although the Merrimack Mills Mall will be its largest venture to date.

The Merrimack Mills site is a good location near the expressway that links Northport to the Metropolitan Boston area. The local economy is reasonably strong though there is some concern that continuing cutbacks in Federal defense spending may be felt by some industrial employers. The mall itself would consist of approximately 350,000 square feet. A quarter of the overall space would be occupied by a single, big name, anchor tenant to draw customers to the center, and thereby encourage smaller satellite tenants to locate there as well. Developers need long-term leases with anchor tenants to obtain project financing. These loans typically run 10 years. Hawkins has a tentative commitment from a pension fund though it's contingent on securing a financeable lease with a credit worthy retailer.

Hawkins recently approached Discount Marketplace, a leading national chain of discount soft goods, clothing, shoes, accessories, housewares, gifts, et cetera. Discount already has more than 200 stores nationwide. It has been expanding its presence in the Northeast. Discount's General Counsel, and Hawkins Senior Vice President have made progress drafting a long-term agreement using Discount's standard lease as a starting point. For the most part, Hawkins is willing to live with the tenant's proposal though some relatively modest revisions were made to satisfy the developer.

Because of its superior bargaining power, Discount was able win favorable rental terms, namely, \$5.50 per square foot. The parties also agreed on an additional 20-year term although four successive options could ultimately extend the period to 40 years. Rental agreements with possible satellite tenants remain to be negotiated. They will be significantly higher per square foot rates, and will generally run for terms of 3-10 years.

Negotiations have recently got stuck over the contract language that specifies how the lease space can be used. Given the length of the lease, Discount insists on having flexibility to change the focus and the operation of its store in light of likely changes in retail marketing. Hawkins, in turn, claims that the lease must narrowly define what products Discount is permitted to sell. Otherwise, it says, prospective satellite tenants will be deterred from leasing this space in the mall out of fear that Discount will try to compete with their businesses. The parties also disagree about whether Discount

should have the right to sublet some of the store space, or to assign its rights and responsibilities under the lease to another company.

You and your assigned counterpart have been called in to try to resolve this deadlock. Your goal will be to reach an agreement in principle that realistically addresses the needs and interests of each party. Lawyers for their respective companies will prepare a formal lease that reflects whatever terms you reach. Unfortunately, this is not the kind of negotiation where impasse on one specific issue can be broken by readjusting other parts of the agreement. It is understood that other provisions of the lease -- its length, and rental rate, for instance -- will not be reopened. Instead, you will focus on the contract language that defines each party's rights and responsibilities.

You're under pressure to get this deal done, but the current language is unacceptable. Your challenge is to figure out a creative, practical solution. As always, you are under no obligation to agree.

You are not in a very strong bargaining position. Unless you obtain a long-term lease with a successful retailer like Discount Marketplace, you will be unable to get financing for your proposed development nor will you be able to attract satellite tenants. Without financing and tenants, your project is dead. It may be possible to find another anchor, but your option on the Merrimack Works is about to expire so you have little time in which to act.

Accordingly, you have tried to be realistic in the negotiations so far, agreeing to most of the provisions in Discount's so-called "standard" lease. (As their representative has said more than once, "The lion gets the lion's share.") You've drawn the line on their Article 22, however, as their language would give them the right to use the space however they liked -- as a department store, a three-ring circus, a video arcade, or a hazardous waste dump. Your only protection would come not from the lease but from general zoning and environmental regulations over which you have utterly no control. Their proposal, moreover, would give them the right to assign the lease or sublet the space to anyone, regardless of their business, reputation, or credit-worthiness.

When Discount claimed that their draft was "company policy," you hastily drafted the counterproposal above, basically prohibiting everything Discount's clause would allow. You realize this probably won't work for Discount but you meant it as "a shot across their bow." Given their experience in the business, Discount itself should be the first to understand why its own Article 22 is unacceptable not just to you, but to your lender and your prospective satellite tenants, as well.

Discount's value lies in its ability to draw customers -- specifically, the right mix of them -- to the mall. These customers come because of Discount's general market reputation and its aggressive advertising. Customers then "cruise" the rest of the mall, which is to the benefit of the satellite tenants. If Discount were to sublet or assign the

lease to another entity, however, the mall might not do nearly as well. A furniture or building supply store would attract a very different clientele, for example.

Moreover, allowing Discount a free hand to assign or sublet could easily create undesirable competition with some of the satellite tenants. If the smallest tenants develop successful businesses within the mall, they would not want Discount to grab it away from them. Satellites would be particularly leery about leasing space in a mall in which the anchor could change its product line at will or whim. Indeed, the stronger such tenants may insist on noncompetition provisions in their own leases.

Likewise with respect to the “use” aspect of the clause, it is important that Discount operates as an off-price retailer of soft goods. If it changed its business (evolving into a supermarket, for example), it could radically change the entire character of the mall. Hawkins is also concerned about rights to sublet. Partitioning the leased space into smaller chunks could have a detrimental effect on the look of the mall. It would also put Hawkins into the peculiar position of having to compete with Discount in seeking smaller tenants.

The bottom line is that Article 22 in its current form is completely unacceptable to you. (You expect that your counterproposal may be equally unworkable for them.) You hope that there is some mutually acceptable solution. Splitting the difference between your two proposals is difficult, however, and might produce a “lose-lose” outcome. Instead you should try to craft a clause that addresses Discount’s fundamental concerns but which leaves you with a viable project.

You have been more than reasonable in accommodating them on other issues, but the use, assignment, and subletting provision is a critical issue. You must maintain as much control over the leased premises as possible. If Discount has problems in the future, you certainly would try to accommodate your key tenant, but you’d like to be in a position where they are coming to you asking for relief, and not vice versa.

Use your energy and creativity to overcome this stalemate, which you and your Hawkins colleagues would very much like to do if possible, but be sure that any proposal you develop is in your company’s best interests, in both the immediate and long-term. You have the authority to sign any agreement that meets Hawkins’s key interest, though your standing in the company would suffer if others felt that you had committed Hawkins to a disadvantageous deal.

If you and your counterpart are able to reach an agreement, jointly draft a clear and simple statement that includes all its essential elements. Your respective lawyers can then translate your understanding to appropriate legal terminology. If you are unable to reach agreement, draft a joint statement noting any issues which you have satisfactorily resolved along with a list of outstanding issues, including each party’s “last best offer.” Remember, however, that Discount’s current proposal is nowhere near acceptable to you, your lender, or your prospective satellite tenants. If Discount insists on it – or anything close to it – you would have no choice but to abandon the entire deal with them.