



## How Simon Finally Stopped Retail Stores from Closing

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A major retail landlord recently won a case that is reverberating throughout the retail industry. An Indiana Superior Court Judge has granted Simon Property Group's ("Simon's") request to enjoin Starbucks from closing 77 of its Teavana stores at Simon malls all around the country. Forcing these stores to remain open and operational is significant given that the Teavana stores are not considered anchor tenants at any of those malls.

"Starbucks noted that no court has ever entered preliminary or permanent injunctive relief to specifically enforce a continuous operations covenant against a non-anchor tenant extending nationwide as Simon requests here (i.e. an injunction regarding 77 lease sites in 26 U.S. states). A review of the case law suggests Starbucks appears to be correct on this matter." (*Simon Property Group, L.P. v. Starbucks Corporation*, Hon. Heather A. Welch, Indiana Commercial Court, Marion Superior Court No. 1, November 27, 2017 Order, (Conclusions of Law, para. 53) ("*Starbucks Order*"))

Despite the lack of precedent, including two prior cases earlier this year in which Judge Heather A. Welch denied Simon's identical requests, this time Judge Welch ordered Starbucks to continue "business as usual in the leased premises" until a final hearing. In winning on its third try, Simon, with a market cap over \$53 billion, flexed its muscle as the leading REIT and shopping mall operator in the United States. Simon's message is clear: it is not going to take the purported "retail apocalypse" lying down.

Continuous operations clauses are not new, but they were understood to control the days and hours of operations, not to support injunctive relief that forces a dying store to continue operating at a loss. In the past when retailers struggled and could no longer pay their rent and make a profit, landlords negotiated early termination deals, mitigated their damages by finding replacement tenants, and marched forward. Now, retailers must think about those clauses in a whole new way.

### How did we get here?

Simon apparently grew tired of national retailers simultaneously closing multiple locations, burdening mall operators with replacing tenants en masse. These closures have also occurred at premium centers, marring upscale properties with dark stores. The occasional early termination is one thing, but with so many recent bankruptcies (The Limited, Wet Seal, Radio Shack, BCBG, RUE21, and Payless, to name just a few), Simon and other landlords are expending increasing resources on re-leasing spaces that they already had leased for years to come. And, Simon argues, it is impossible to calculate the damages dark stores have on the performance of other stores in a center.

Seeing the growing problem, Simon fired its first mortar at Kenneth Cole, which announced last winter that it was shuttering 30 stores in Simon malls before their lease terms were up. Simon sued Kenneth Cole in Simon's hometown of Indianapolis, seeking injunctive relief requiring Kenneth Cole to continue operating its stores. Judge Welch drew the case and, after an evidentiary hearing,

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denied Simon's request. Simply put, Judge Welch determined that the harm Simon would suffer from 30 Kenneth Cole stores shutting down early was not nearly as great as the harm Kenneth Cole would suffer from having to operate them. (*Simon Property Group v. Kenneth Cole Consumer Direct, LLC*, Hon. Heather A. Welch, Indiana Commercial Court, Marion Superior Court No. 1, January 8, 2017 Order ("*Kenneth Cole Order*")

## Simon sues Wolverine World Wide

Shortly thereafter, Wolverine World Wide announced that several branded stores in its family, including Stride Rite, Hush Puppies and Sperry, would be closing before their lease terms were up. With about 70 of those stores in Simon malls, Simon had its next defendant. Simon sued Wolverine in the same Indianapolis Court, arguing that Wolverine, a profitable company with revenue of over \$2.5 billion and one of the leading marketers of branded footwear, should not be able to shed its non-performing subsidiaries' stores to the detriment of the tenant mix at Simon's malls. Simon expert John Talbot testified that, "a shopping center is not a random collection of stores; it is a co-dependent ecosystem with a complex system of governance that ensures its well-being." (*Simon Property Group v. Wolverine World Wide, Inc. et al*, Hon. Heather A. Welch, Indiana Commercial Court, Marion Superior Court No. 1, March 24, 2017 Order ("*Wolverine Order*")

More importantly, argued Simon, the "retail apocalypse" is upon us, and the sky is falling on landlords.

Wolverine, though, presented corporate representative and expert testimony that the stores at issue remained unprofitable despite best efforts to prop up the retailers' mall locations. Instead, Wolverine now sells most of its shoes through other channels, such as online or at big box stores. Continuing to operate the unprofitable stores, Wolverine argued, would only bring down the company. Wolverine's expert testified that he analyzed the finances of the subsidiaries and determined that the stores at issue "are unable to operate profitably" despite Wolverine's best efforts. A corporate representative testified that, without the ability to close the stores at issue, bankruptcy might be the only option for the subsidiaries operating those stores.

But, Simon's cries of woe fell on deaf ears in light of its strong financial performance. The Fortune 500 company made a profit of \$1.8 billion in 2016. That was possible because of metrics that any retail landlord would die for: 96.8 % occupancy, base minimum rent per square foot of \$51.59, leasing spread of over \$7.82, and average sales per square foot of \$615. Wolverine presented this evidence of Simon's success despite many retail closures. "Simon has succeeded by adding new retailers that people want and replacing retailers that people no longer want in its centers." Surely, to the extent the retail apocalypse is reality, Simon has so far gone unscathed.

Therefore, although the *Wolverine* case, with more stores at issue and a financially healthy defendant parent company, presented a closer call for Judge Welch than the *Kenneth Cole* matter, she still denied Simon's request for a preliminary injunction. "While the Court appreciates generally the impact these type of mass closings will have on shopping centers, the lack of specific harms gives this Court pause to enforce an injunction given the immediate harms presented to [Wolverine]."

## Simon Sues Starbucks

Simon settled with both Wolverine and Kenneth Cole following Judge Welch's Orders, negotiating termination and reduced rent deals that are typical in the industry when stores close early. However, it was not long before Simon focused on another target - this time global retail giant Starbucks.

The similarities are strong between those cases and the facts against Starbucks. As was the case with *Wolverine* and *Kenneth Cole*, Starbucks' leases with Simon have continuous operations clauses, some running until 2027. Although the leases also contain typical liquidated damages provisions, those clauses are superseded by other language that is routinely included in retail leases: "In addition to all other remedies, Landlord shall have the right to obtain specific performance by Tenant upon Tenant's failure to comply with the provision of this Section 8.2." Still, though, many of the Wolverine and Kenneth Cole leases had similar language. The fact remained that the Teavana stores are not anchor stores. Simon could not argue that losing any Teavana store would violate co-tenancy requirements of any other leases. And, they could not argue the Teavana stores had much impact on foot traffic. Considering that the performance of

Simon's malls continues to be strong, where did Judge Welch find the evidence to distinguish this case from the others?

It turns out that the financial viability of the tenant was the key. Although only 77 Teavana stores were at issue, Simon successfully argued that the potential harm to Starbucks should be considered because Starbucks merged with its former subsidiary in 2016 and became the tenant on all of its leases. The Court determined that Teavana was only a brand of Starbucks and not a separate entity. Unlike its struggling tea brand, Starbucks as a whole has a market cap over \$80 billion and made a profit of over \$4 billion in the last fiscal year. So, while Simon is flourishing, it gained the high ground on an evaluation of relative damages in this case when juxtaposed with Starbucks' even greater financial success.

Importantly, Judge Welch noted that Starbucks' expert – responsible for providing evidence of Starbucks' losses resulting from operating the poor performing Teavana stores and showing the relative harm to Starbucks if it was forced to continue operating them – had "discrepancies" in his testimony. Starbucks' expert testified that the company would lose \$15 million if it had to keep operating the stores until a final hearing in October 2018. However, the Court noted several holes in his testimony. For example, he did not include sales anticipated in the last two months of the year, when the stores expect to earn 40% of their annual revenue. And, he conceded that he relied on several estimates of "regional overhead" and a \$6 million cost of a distribution center in his calculations.

"For these reasons, the Court finds Mr. Menenberg's opinion that Starbucks would sustain a loss of \$15 million in operating Teavana stores between February 1, 2018 and October 2018, is an inflated estimate, and therefore lacks credibility." The Court concluded that, "Unlike in previous injunction cases before this Court involving Simon malls, Starbucks has testified that it is seeking to close the 77 Teavana stores in contravention of the Continuous Operation Covenants simply as a cost cutting measure where the existence of the company was not an issue." The Court also considered the relative impact of each Teavana store on the mall in which it is in, as well as the collective impact of closing 77 stores at the same time in malls around the country. In looking at relevant case law, the Court concluded that, "The shared pattern in these cases where irreparable harm was not found is that courts rarely find the premature closure of a single store to cause such substantial harm to a shopping center as to deem that harm irreparable."

However, Judge Welch was persuaded by Simon's "big picture" argument. "Simon's theory is that if a financially secure organization such as Starbucks can unilaterally decide to remove itself from Simon's malls early in spite of any Continuous Operation Covenants, then any Simon tenant would be able to prematurely leave without any concern that a court may compel them to specifically perform the terms of the lease."

And there is the rub. Simon finally had the perfect defendant with which to make its point that tenants must have some respect for continuous operations obligations. Starbucks' not only is financially strong, but it also made the mistake of overstating the degree of Teavana's struggles and lost credibility. Simon, and Judge Welch, pounced; sending a message throughout the industry.

## **The Challenge of Enforcement**

Now, Starbucks is compelled to operate underperforming stores it has publicly declared it wants to close. What about enforcing compliance? In *Kenneth Cole*, Judge Welch saw this as a major barrier to injunctive relief. She noted that the Court would be charged with overseeing compliance despite its overwhelming docket of 2400 open cases. "The Court has little bandwidth to extend to such a venture. The Court does not have experience in the matters of retail management to know when staffing and inventory levels are sufficiently appropriate, so the Court will either have to spend additional time acquainting itself with such procedures or rely heavily on outside advice..."

But that language is nowhere to be found in the Starbucks Order. Instead, Judge Welch pointed out that Simon had never before had a problem with Teavana's operations, so it expects the operations to continue as before. If not, she cited the ability to appoint an Independent Commercial Court Master to supervise compliance. "Moreover, of much greater concern here than any potential costs of monitoring compliance is the State's strong public policy in favor of enforcing parties' contract." Make no mistake; that is not just the public policy of Indiana, but all states.

Still, though, Judge Welch has taken on the responsibility of overseeing Starbucks' compliance with its responsibilities – is Starbucks putting commercially reasonable efforts into the operation of these stores, or is it simply doing the bare minimum to keep them open? As the Court stated, it is forging new ground in the retail industry.

To be clear, this is not a final order. A final hearing could result in a different outcome lifting the injunction. Of course, the more likely result is that the parties will now reach a settlement, with Simon having gained considerable leverage in this matter, and surely in future disputes with other tenants seeking to get out of leases early.

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