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RETAIL PERSPECTIVES

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In California Malls, Free Speech Rights Reign Supreme: *An Analysis of Snatchko vs. Westfield LLC*

In a ruling published in August, the California 3rd Appellate District overturned a lower court decision and declared that certain common area rules imposed by the owner of a large regional shopping mall in Roseville, California are "unconstitutional on their face" because the rules prohibited peaceful, consensual, spontaneous conversations between strangers about topics not related to the mall, its tenants or their related activities. *Matthew Snatchko v. Westfield LLC et a*l. (Cal.App.3rd, August 11, 2010). It should be noted that the opinion was authored by Tani Cantil-Sakauye, the current nominee for chief justice of the California Supreme Court.

At the heart of the case are the actions of Matthew Snatchko, a 27-year-old youth pastor. Snatchko often visited the Galleria at Roseville in search of opportunities to share his Christian faith. While in the common area one evening, he approached three young women who agreed to talk with him. A store employee reported Snatchko's activities to mall security, who, after observing some "nervous behavior" by the women, asked Snatchko to stop talking to the women or leave the mall. Snatchko refused; the officer called for backup and a senior security officer responded and ordered Snatchko out. When Snatchko continued to refuse, the security officers placed him under citizen's arrest, handcuffed him and then turned him over to Roseville police. Snatchko was booked and released, and when he appeared in court for arraignment, all charges were dropped. The

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Top Ten Issues In Co-Tenancy Provisions In Retail Leases

As many real estate professionals are aware, the co-tenancy provision is one of the more heavily negotiated provisions in a retail lease. A co-tenancy provision permits a tenant to exercise remedies if certain conditions are not met with respect to the shopping center in which it is located. As discussed below, co-tenancy provisions can be tied to the existence of certain "key" tenants or to an occupancy threshold based on a percentage of total tenants or to a square footage number. Tenants want co-tenancy provisions, which may relieve them from being obligated to open, pay full rent or operate in a shopping center that is not fully occupied, to provide for a remedy in the event that the synergy of the applicable shopping center is affected. Landlords dislike co-tenancy provisions because (i) they cannot control the actions of other tenants or occupants in the shopping center, (ii) they feel that a certain amount of vacancy is unavoidable, and (iii) their rent stream from the shopping center can be severely impacted. This article will briefly discuss the top ten issues in co-tenancy provisions in retail leases.

1. **Leverage.** Whether or not a tenant is successful in obtaining a co-tenancy provision is largely dependent on the negotiating leverage that the tenant possesses. National and large regional credit tenants are generally highly sought after by landlords because of their name recognition, ability to pay higher rents and staying power, and "hot" tenants are desirable because they have drawing power and can increase the cachet and prestige of a shopping

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center. Such tenants usually are in a better position to obtain co-tenancy protection than smaller regional, lesser credit and shop ("mom and pop") tenants. However, in the current market, some of such smaller tenants are also requesting, and in some cases getting, co-tenancy protection. The reasoning is typically that, with the economy struggling, a "mom and pop" tenant will need to be sure that the major and mini-major tenants who generate a fair amount of foot traffic will be open and operating. Without such foot traffic, and with consumers being more and more careful with their disposable income, the "mom and pop" tenant could really suffer.

2. **Opening Co-Tenancy**. Co-tenancy provisions fall into two categories. The first is an opening co-tenancy, which provides that a tenant need not open its store at full rent unless and until certain other stores, or a certain amount of stores, in the shopping center are open. An opening co-tenancy is usually found in the context of a shopping center in development, which may still be in the entitlement, lease-up or construction phase, but may also be found in an existing shopping center that is being renovated. Likewise, in the case of a shopping center in an outlying growing area where demographic projections are still somewhat conjecture, a tenant will want assurances that the shopping center will be built and occupied before it commits itself to that shopping center.

3. **Operating Co-Tenancy**. The second category of co-tenancy provisions is an operating co-tenancy, which provides that once a tenant has opened and is operating, it will be obligated to stay open at full rent only if certain other stores, or a certain amount of stores, are also operating. An operating co-tenancy is not limited to any particular type of shopping center, as no matter where the shopping center is located or how old or new it is, a tenant will not want to be required to stay open in a shopping center where other stores are closing.

4. **Key Tenants**. Co-tenancies usually are geared to certain "key" tenants, so-called because they are viewed by the tenant seeking co-tenancy protection as "key" to the success of the shopping center and/or the particular tenant. For example, a tenant generally will not want to be obligated to open or keep operating its store at full rent unless the anchor store in the shopping center, usually a department store in a regional mall or a grocery store in a neighborhood shopping center, is also open and operating. Where there is no true anchor store – *i.e.*, no store is dominantly larger than the other sizable stores (such as in a power shopping center) – a tenant may not want to be open or operate at full rent unless a certain number of mini-major (roughly 15,000 to 30,000 square feet) stores are also open and operating. And sometimes, a tenant may require that a certain percentage of the shopping center be open or operating before that tenant has to open or keep operating at full rent. Often, a tenant with significant negotiating power will require that a combination of two or even all three of the above be satisfied before it must open or keep open its store at full rent – *e.g.*, a tenant may require that one of two anchor stores, four of seven mini-major stores, and 75% of the shop spaces, or at least 100,000 square feet of space in the shopping center, be open before that tenant is required to open its store and begin operating, or, if already operating, to keep operating at full rent.

5. **Replacement Tenants**. Tenants seeking co-tenancy protection typically specify the name of the anchor and/or mini-major store(s) that must be open and operating, as landlords usually try to obtain commitments from anchors and mini-majors before committing to develop a shopping center, and the tenant is relying on the existence of that (or those) particular tenant(s). While a landlord may agree to a co-tenancy provision, it will want to avoid being locked into the specifically listed stores, because landlords are only too aware of the fickleness of the retail sector – today's "hot" retailer might be in bankruptcy court in a few years. Therefore, landlords will typically require that a co-tenancy provision is satisfied if a "replacement" tenant is open and operating in lieu of a key tenant that is no longer operating. This is usually acceptable to tenants if the replacement tenant is comparable to the named or departing tenant. For example, a landlord may require that a replacement tenant which occupies most of the vacated space, has a similar (*i.e.*, soft goods or electronics) business, and is comparable in creditworthiness to the departing tenant be deemed to satisfy a co-tenancy provision.

6. **Conditions**. Before a tenant can invoke a remedy under a co-tenancy provision, a landlord will want the tenant to satisfy certain conditions. Foremost is that the tenant is not then in default under the lease, but such conditions may also include that the tenant is itself operating at the time of a violation of the co-tenancy provision, and that the right to invoke

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the remedy is personal to the original tenant that signed the lease. A landlord may also require that the tenant show a drop in sales during the co-tenancy violation period as compared to the period prior to the violation. Finally, a landlord will want to make sure that, if the tenant invokes a co-tenancy provision, the remedy elected by the tenant for such co-tenancy violation is the tenant's sole remedy for such violation. A landlord does not want to be in a situation where the tenant obtains the benefit of a co-tenancy violation remedy, such as rent abatement or termination, only to have the tenant sue for other damages.

7. **Cure**. A landlord will also want to have the right to cure a co-tenancy violation before the tenant can invoke any remedies, as the violation might occur with little or no warning, such as a bankruptcy filing. The cure right almost always involves the right to try to obtain replacement tenants for the key tenants, or, in the case of an occupancy threshold, to try to fill the vacant space. Therefore, most landlords will agree to a co-tenancy right only if the violation continues for a significant period of time, with the amount of time depending on the types of remedy that the tenant may elect.

8. **Remedies**. A tenant's remedies for a co-tenancy violation fall into three categories. The first such remedy is rent abatement, where if a co-tenancy violation is not cured within the stated time period, the tenant has the right to pay a lesser rent for so long as the co-tenancy violation exists. The lesser rent is typically based on either a percentage of the fixed annual rent (usually 50%) or percentage rent only during the violation period. The second remedy for a co-tenancy violation is termination of the lease, but as this is an extreme remedy, landlords are loathe to grant it unless the co-tenancy violation continues for an extended period of time – at least six months, often a year, and even longer if the space is particularly large (such as a space occupied by Target, Home Depot or Wal-Mart). An operating co-tenancy provision will usually allow for rent abatement and termination (because rent abatement is not as drastic, a landlord will often permit a tenant to invoke that remedy sooner than the termination remedy, often as soon as the violation occurs) The third remedy for a co-tenancy violation only arises if there is an opening co-tenancy violation, and allows the tenant to delay the opening and/or rent commencement date (although most tenants will also want to have the right to open but with rent abatement as set forth above).

9. **Return to Full Rent; Recapture**. If a tenant elects rent abatement, the landlord will not want the tenant to be able to take advantage of the substitute rent provision for the remainder of the lease term. In such an instance, a landlord will typically require that if the co-tenancy violation is not cured within a certain period of time (typically one year) and the tenant has not terminated the lease within that time, then the tenant will have to return to paying full rent. The obligation to return to paying full rent is based on the theory that if the tenant is remaining in the shopping center despite the co-tenancy violation it must believe that its store is doing well enough to warrant continuing at full rent. If the tenant does not want to return to full rent, then the landlord will usually insist on the right to recapture the premises.

10. **Reimbursement**. If either party terminates the lease due to a co-tenancy violation, the tenant will want to be reimbursed for its unamortized leasehold improvements (typically amortized on a straight-line basis over the initial term), since the termination was not due to an event within the tenant's control. However, reimbursement should only apply during the initial term of the lease, as that is the length of time on which the tenant based its original decision to enter into the lease. A landlord will want to avoid making any payment to the tenant, as the landlord will already have lost the rental income stream from the applicable lease.

In summary, while landlords may use whatever bargaining power they possess to avoid granting a co-tenancy provision in a retail lease, the circumstances may dictate that a deal will not get done without one, especially in the current economy. In such a case, the negotiation of the co-tenancy provision will raise several issues that both the landlord and tenant will need to address to arrive at a compromise that will satisfy both parties.

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Placer County District Attorney later stipulated that Snatchko was factually innocent, and a Superior Court judge issued an order stating the same.

Snatchko sued Westfield, the owner of the Galleria, the security firm employed at the Galleria, and the arresting officer. He claimed monetary damages in an unspecified amount for false imprisonment, assault, battery, intentional infliction of emotional distress, negligence, malicious prosecution, and a general violation of his rights under the Unruh Civil Rights Act.

The specific common area rule at issue prohibits a person from approaching other people in the common area with whom he or she was not previously acquainted for the purpose of communicating about a topic unrelated to the business interests of the mall or its tenants or a non-commercial activity sponsored by the mall or a tenant without first applying for, and receiving, a permit from Westfield.

The Court began its analysis of this rule with the landmark 1979 California Supreme Court ruling in *Pruneyard Shopping Center v. Robins*. In *Pruneyard*, the Court held that Article 1, Section 2 of the California state constitution protects the rights of free speech, reasonably-exercised, in a privately-owned shopping mall. With Pruneyard as the starting point, the Court applied the type of free speech analysis generally used for governmentally-imposed speech restrictions to Westfield's common area rule.

The first step in the analysis was to determine whether the permit requirement for common area speech is triggered by the specific words, ideas and content of the speech, or if the permit requirement applies equally to all types of speech regardless of the specific words, ideas and content being expressed. After several pages of analysis, the Court concluded that the Westfield common area rule is triggered by the specific content of the speech. The Court reasoned that conversations between strangers—even consensual, spontaneous and non-disruptive conversations—regarding topics that are unrelated to the business of the Galleria and its tenants are limited by the permit requirement. In contrast, the Westfield rule allows anyone to discuss matters related to the Galleria, its tenants, or noncommercial activities sponsored by the mall without a permit or other interference.

Since the Westfield common area rule limits specific types of speech between certain types of speakers (*e.g.*, words, ideas and content unrelated to the Galleria) but freely permits other types of speech with no restrictions (*e.g.*, words, ideas and content related to the Galleria), the Court determined that the rule is "content specific". Because the rule is content specific, the Court stated that the rule must pass a higher threshold in order to be deemed constitutional. Westfield needed to prove that its content-specific limitation on common area speech was both necessary to serve a compelling interest, and narrowly tailored to achieve such interest.

Westfield argued that its limitation on strangers discussing topics not related to the business of the Galleria and/or its tenants in the common area served a compelling interest in reducing mall congestion and promoting public safety. The Court rejected this argument because the rule would permit an unlimited number of friends and acquaintances from congregating and talking in the common area. Westfield also claimed that the common area rule promoted its compelling economic interest in providing a convenient, comfortable shopping atmosphere to its patrons. The Court resoundingly rejected this claim as well, stating that providing a stress-free shopping experience is not a compelling interest when compared to the importance of free speech rights. The Court then went on to find that Westfield's common area rule is not narrowly tailored to the least restrictive means of promoting its alleged compelling interest. The Court reasoned that the Westfield rule is overbroad and prohibits more speech than is necessary.

Although the Court could have ended its analysis at this point and overturned the Westfield rule, the Court continued in its analysis. The Court said that even if it determined that the Westfield rule applied to all speech equally regardless of the specific content, the rule would still not survive constitutional review. To prove this point, the Court applied the lower standard of review appropriate for so-called "content-neutral" speech restrictions: does the content-neutral restriction burden more speech than necessary to further the interests protected by the speech restriction? Again, the Court determined that the Westfield common area rule was overbroad and limited far more types of speech than necessary. The Court specifically described a number of types of consensual, spontaneous conversations between strangers in the common area

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that are prohibited by the Westfield rule, including discussions regarding sports, the weather or other types of "chit chat". The Court labeled these types of conversations as "classic free speech" and found that such conversations should not be unduly restricted.

Accordingly, based on the Snatchko ruling, it seems advisable to carefully review common area rules so as to ensure that the rules permit spontaneous free speech regarding any and all topics between strangers who mutually agree to converse and who cause no disturbance or otherwise interfere with the operation or enjoyment of the shopping center.

From available media accounts, Westfield is deciding whether to appeal the case.

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