

August 2017

Surviving the Retail Shift

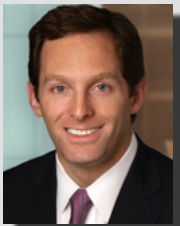
Part 2 of a 5 Part Series:

A Landlord's Duty to Mitigate its Damages

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In [Part I of this five part series](#), we addressed managing the legal process to help commercial landlords achieve the most efficient results when dealing with defaulting retail tenant. But, what happens once the shopping center owner or manager recovers possession of the lease premises?

Part II. Now What? A Landlord's Duty to Mitigate its Damages.

When a retail tenant vacates its leased premises early, the landlord's goal is generally two-fold: (1) be compensated for the financial loss from the vacating tenant, and (2) find a replacement tenant as soon as possible. While these two goals seem unrelated in practice, especially as the legal department may step in to handle collection, and the leasing department begins its efforts to re-lease the space, a landlord's success in collecting future rent and other damages from the vacated tenant can be significantly affected by what efforts are (or are not) taken to re-lease the now vacant space.

When a commercial landlord recovers possession of its leased premises early, it generally has two options under typical lease terms: (1) sue for rent installments as they come due; or (2) terminate the lease and make due immediately all of the rent that would have otherwise become due through the end of the lease. In response to a landlord's demand for future rent – whether at the conference table or in a courtroom – the tenant typically challenges the extent of the landlord's efforts to re-lease the tenant's former space. **The laws of most states require a landlord to take reasonable efforts to mitigate its damages when a tenant vacates its leased premises prior to the end of the lease term.** If a landlord fails to undertake these reasonable efforts, or if a landlord has the opportunity – but fails – to re-lease the premises to a replacement tenant, the landlord's recovery will likely be reduced by the amount the landlord would have recovered from that replacement tenant.

General contract principles require a party take reasonable efforts to minimize its damages when the other party breaches a contract. This requirement historically did not apply to leases because they were viewed as conveyances of real property interests. Over the past few decades, however, courts and lawmakers alike have started treating leases more like contracts, and the laws of at least 28 states now impose a duty on landlords to mitigate their damages. This trend is not uniform, however, and there are several important distinctions depending on which state's law applies.

The duty to mitigate damages generally requires only that a landlord take "reasonable" efforts reduce its damages. The reasonableness of a landlord's efforts may depend on many factors. As the Kansas Court of Appeals remarked in *Leavenworth Plaza Associates, L.P. v. L.A.G. Enterprises*, 16 P.3d 314 (Kan. App. 2000), what may be considered commercially reasonable efforts to lease space in a brand new shopping center in a growing area with national retailers competing for space is different from what may be commercially reasonable efforts to lease space in an older mall with minimal improvements. Regardless of the age or type of shopping center or the prevailing present economic conditions, decisions from around the country provide some guidance and suggest a landlord cannot be passive and simply post a "For Lease" sign or field incoming phone calls. The landlord must actively seek a replacement tenant, although they are certainly limits to the efforts that must be undertaken.

Many courts looked beyond merely posting – or failing to post – a "For Lease" sign on the premises so long as the landlord's leasing efforts are consistent with its normal leasing activity and are supported by a legitimate business reason. For example, the Missouri Court of Appeals held that a landlord's failure to advertise the property or place "For Lease" signs on the premises did not make its leasing efforts unreasonable. *MRI Northwest Rentals Investments I, Inc. v. Schnucks-Twenty-Five, Inc.*, 807 S.W.2d 531 (Mo. Ct. App. 1991). The landlord testified in that case it typically does not place "For Lease" signs on vacant retail properties because it gives the shopping center a negative image with potential lessees and customers. The Arizona Court of Appeals reached a similar

result in *Wingate v. Gin*, 148 Ariz. 289, 291 (Ariz. Ct. App. 1985).

In contrast, the Colorado Court of Appeals held that a landlord failed to take reasonable efforts to re-lease vacant space because it failed to do anything other than accept calls from parties expressing an interest in the property. The landlord did not list the property with a real estate agent or a multi-listing directory, advertise the vacancy in a newspaper or other publication, or place a sign on the property. *Pomeranz v. McDonald's Corp.*, 821 P.2d 843 (Co. Ct. App. 1991). Likewise, the Iowa Supreme Court held that doing nothing more than placing of a "For Lease" sign was not sufficient evidence of reasonable efforts. *Vawter v. McKissick*, 159 N.W. 2d 538, 541 (Iowa 1968).

While these cases certainly do not canvass the entire landscape, they do provide some guidance that should be applied regardless of the jurisdiction. A landlord must actively and diligently seek a replacement tenant in the same manner as the landlord would try to lease other dark space in its shopping center.

Undertaking these efforts by themselves is not enough, however. The landlord may be required to provide proof of these efforts, either with live testimony or documentary evidence. A landlord's failure or inability to provide such evidence could, in some jurisdictions, result in the landlord being denied any recovery for rent that accrued after the landlord recovered possession of the dark space.

Of the 28 states that impose a duty on landlords to mitigate their damages resulting from a defaulting tenant, about half put the burden of proof on the tenant, five of them put the burden of proof on the landlord, and eight are silent on the issue. In 13 states, a landlord's recovery will be reduced or barred altogether due to a landlord's failure to mitigate its damages only if the tenant proves that the landlord failed to take reasonable efforts to re-lease the vacant premises. In Illinois, Iowa, New Jersey, Oregon and Utah, however, the burden of proof falls squarely on the landlord. If a landlord in these states fails to prove that it took reasonable steps to mitigate its damages, the landlord will not be able to recover any future rent from the defaulting tenant.



One of Illinois's appellate courts affirmed the reasonableness of a landlord's efforts to mitigate damages because the landlord provided evidence it erected a sign and placed calls to brokers and developers seeking to re-lease property; the landlord obtained some short-term rentals. Moreover, the landlord's expert opined the rental price and marketing strategy were reasonable. *MXL Industries, Inc. v. Mulder*, 252 Ill. App. 3d 18 (Ill. Ct. App. 1993).

Connecticut is one of the eight states that is ostensibly silent on which party bears the burden of proof, but one of its courts denied a landlord recovery because the landlord did not hire a real estate broker until almost four months after the tenant defaulted and provided no explanation for this delay. Likewise, the landlord did not introduce any evidence by its broker to establish what efforts were made to lease the premises. *Rokalor, Inc. v. Connecticut Eating Enterprises, Inc.*, 18 Conn. App. 384 (Conn. Ct. App. 1989).

While most landlords of retail space are motivated to re-lease dark spaces regardless of the duty to mitigate damages, this motivation does not always lead to success, particularly in the current retail environment. It is not the landlord's success in mitigating its damages that matters, however, it's the efforts the landlord has undertaken. Therefore, it's critical retail landlords document their marketing efforts and are prepared to explain to a court precisely why those efforts are in line with the applicable market. **If a landlord is unsuccessful in leasing vacant space and cannot prove that its leasing efforts were reasonable, those efforts will surely have been wasted.** After all, they will not have resulted in a replacement tenant or satisfied the landlord's duty to mitigate its damages both of which will likely lower total recovery for the shopping center.

In an effort to navigate or control their duty to mitigate damages, many retail landlords include boilerplate provisions their leasing modifying or waiving this duty altogether. Before relying on these types of provisions, it is important

to evaluate the enforceability of them in the particular state where the shopping center is located. The Texas legislature, for example, has enacted a statute expressly prohibiting lease provisions that purport to waive a landlord's duty to mitigate its damages. See Tex. Prop. Code 91.006(b). On the other hand, courts in New York, North Carolina, and Ohio have enforced provisions that contractually excuse the landlord's duty to mitigate. See *Sylva Shops LP v. Hibbard*, 623 S.E.2d 785 (N.C. Ct. App. 2006); *New Towne LP v. Pier 1 Imports, Inc.*, 680 N.E.2d 644 (Ohio Ct. App. 1996). Explaining its rationale to enforce these types of waivers in a commercial lease, a New

York court explained, "[a] commercial tenant which has negotiated a lease which provides that the landlord need not mitigate damages may take proper precautions against the possibility of default, may seek to assign or sublet, or may simply defer abandoning the lease." *29 Holding Corp. v. Diaz*,

The duty imposed on landlords in many states to mitigate their damages is not extraordinary in practice. It requires the same efforts that a typical landlord takes every day to fill empty spaces in its shopping center.

Where some landlord's go astray, however, is by failing to recognize the importance of documenting and ultimately proving these efforts. Similarly, as landlords are faced with more dark spaces in their shopping centers, many landlords are considering creative uses for these vacancies. While these efforts may satisfy a landlord's duty to mitigate its damages, alternative uses for dark space may create other problems for landlords.

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In Part III, "Balancing Creative Uses and Co-Tenancy Requirements", we will address some implications of creative uses on co-tenancy and excessive-vacancy provisions amid this retail storm.



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