

CONVENIENCE STORE LEASING

David E. Vieweg
Fennemore Craig P.C.

A. Introduction.

A convenience store lease is a hybrid retail lease with numerous typical retail provisions and some unique features, particularly when the lease contemplates the retail sales of motor fuels from the site. A convenience store is often a freestanding building, and the vast majority of sites selling motor fuels will be freestanding locations. Pad locations at entrances to shopping centers are a popular choice for motor fuels operations. Alternatively, a convenience store may have an inline location, most commonly at an endcap position for signage, visibility and parking reasons.

In common with other retailers, convenience store operators will be concerned about signage rights, signage location, parking rights and direct or otherwise uncomplicated access to the store from nearby streets. Permitted uses and exclusive uses will be critical. Permitted uses must be broad in order to assure the right to move into new product lines, and exclusive use provisions, commonly taking the form of a list of items the operator has an exclusive right to sell in a shopping center, give the operator some protection of its ability to conduct business in a profitable fashion. When motor fuels are to be sold, issues abound as to environmental compliance obligations, end of term remediation requirements, and what happens to the underground storage tanks, lines, dispensers, islands and canopies.

B. Common Retail Issues.

1. Access. When seeking to ground lease a freestanding site where the landlord doesn't own any contiguous property and the site is not part of a greater retail development, all necessary ingress and egress points to adjoining streets must be located on the site or else there needs to be a plan for obtaining necessary access rights from adjoining landowners through an access easement agreement or similar instrument.
2. Signage. Retailers are very concerned about their signage rights, with respect to size, visibility and design. Particularly for large regional or national retailers, their signage is a major piece of their 'brand', and they will not abide any restrictions on the design and colors of their corporate logos. This does not often become a major issue, but can be the stuff of interesting discussions with shopping center architectural control committee members who are concerned with preserving design themes throughout the center. As to signage size, c-store operators simply want the maximum permitted by law. Signage size goes directly to signage

visibility, and an operator will not want its store to be the best kept secret in a shopping center.

3. Parking. When ground leasing a pad, the c-store operator will presume to have exclusive parking rights with respect to all parking spaces to be located on that pad. That presumption may not play out when the pad is part of a shopping center with CC&Rs which require all parking spaces throughout the center to be available to all. With respect to in-line space, having exclusive spaces at least directly in front of the store will be critical. And it will be important to try to prohibit ‘parking pigs’ from operating nearby and precluding the quick and easy access which is such a large part of the concept of a c-store.
4. Permitted Uses.
 - a. In General. Even a very casual c-store customer will be aware of a significant shift in the product mix offered by national convenience store chains over the last decade or two, and major changes are currently underway as some chains are moving towards fresh produce, freshly made sandwiches and pastry, and even prepared hot meals. Consequently, the use permitted under the lease—the items permitted to be sold—will be very broad and even amorphous around the edges, as an ability to move into new and unanticipated product lines has to be built into the lease.
 - b. Other Uses. So far I have been addressing only the types of products one might encounter in a convenience store. But what of exit strategy concerns? How important is it to also allow for ‘and any other lawful retail use’, possibly subject to some noxious use limitations? If we are talking about national c-store operators, the answer is ‘not very’. Landlords in shopping centers often say that they want a certain pad in their center to be operated as a c-store with gas, period, and it can be difficult to obtain much in the way of flexibility in this area. For companies like 7-Eleven and Circle K Stores, that is often acceptable, although not desirable, so long as the permitted use clause is as broad as possible as to actual and potential c-store items—the key here is that landlord is not allowed to grant exclusives to other tenants in the future which can cut back any items then being sold by the c-store. From an operational standpoint, it would be much more problematic if a landlord insisted on the right to approve items not sold today that the company wanted to sell in the future. However, smaller operators would be well advised to have the right to use the premises for other retail purposes, even if that is subject to both landlord’s consent and any exclusive use rights landlord has granted to other tenants of the shopping center.

5. Exclusive Use Rights. The next question relates to how the operator can best protect its sales.
 - a. The Property Encumbered. The first consideration is—what other property besides the Premises does the landlord own or otherwise control? In the shopping center context, does landlord own the whole center or only the pad being leased? If landlord owns the whole center, the operator can negotiate exclusive use rights in the lease and place them of record through a memorandum of lease. If landlord owns only the pad, the operator will have to try to amend any existing CC&Rs for the center to include its exclusive use rights. That is a much taller order, and the best strategy would be to provide in the lease that such a modification of the CC&Rs is a condition precedent to the commencement of the term of the lease, thus enabling the operator to terminate the lease if ultimately unsuccessful in obtaining an acceptable modification.
 - b. The Exclusive Use Provision. What about the content of the exclusive use provision? The most effective protection prohibits other occupants of a shopping center from selling specific items: cigarettes and other tobacco products, beer and wine for off-premises consumption, packaged milk, soft drinks in six packs or one liter bottles, coffee by the cup, packaged snack items, packaged bread products and bakery and pastry items, and so on. If the store is selling retail motor fuels, the operator will want to be the only seller of gas in the center. Where there is a grocery and/or pharmacy in the center, those tenants will be carved out of the exclusives—the best the operator can do is prevent the small, in-line tenants from selling competing products.
 - c. The Case of Starbucks. Co-existing with Starbucks can be a bit of a challenge. National c-stores are moving up-scale in terms of the quality of the fresh food and beverages available, and Starbucks has its own preferred exclusive use provision which would undercut a c-store's ability to sell some important items. A compromise which has been worked out allows the c-store to sell from this location the items which Starbucks otherwise has an exclusive right to sell, provided that the items may only be sold in prepackaged containers or made available to customers on a self-service basis. In other words, the right to sell a coffee-based drink ordered by a customer and made by an employee on-site belongs exclusively to Starbucks, but 7-Eleven may sell cups of coffee which are customized to taste by the customer.

6. Common Area Maintenance.

- a. Shopping Center Lease (In-Line Space). Where the c-store is operating out of in-line space, there are no special issues raised except if the c-store has a gas facility. As mentioned before, this is an increasingly rare situation, but it does happen. The operator has to protect the motor fuels islands from any changes initiated by landlord; in essence, the operator has converted some portion of the common area to an exclusive use area. Landlords occasionally respond by insisting that this situation be factored into the determination of the operator's pro rata share of common area maintenance expenses, perhaps by adding the square footage of the canopy to the square footage of the store to determine the numerator in computing the pro rata percentage.
- b. Ground Lease Issues. When the operator is ground leasing a pad in the center, other issues arise. The operator will be responsible for maintaining and repairing all of the ground being leased and the improvements constructed on the ground, including those portions which would otherwise constitute common area in the shopping center. But if landlord proposes to require the operator to pay common area maintenance expenses based on a land-to-land calculation, the operator will be double-billed with respect to landscaping costs and various maintenance and repair expenses. A fair resolution may take one of several forms: the parties may agree that landlord will maintain the landscaping, asphalt and other common area-type portions of the Premises; or the operator may contribute a reduced amount towards common area maintenance expenses. As various major arterials in the center are often of benefit to the operator by providing convenient access from other parts of the center to the pad, an agreement to pay a proportionate share of the maintenance and repair of those passageways would be an appropriate compromise.

C. Motor Fuels Issues.

Convenience store leases diverge from other retail leases when motor fuels are going to be sold. Pre-term investigation of the land, operating issues during the term and post-term remediation requirements add additional and potentially challenging issues to the lease negotiations.

1. Pre-Term Investigation. When motor fuels are to be sold from a location, the pre-term environmental investigation of the property will be much more detailed. If the land to be leased has not been developed, a Phase I report with photos and historic information as to use may suffice; some soils sampling may be conducted to detect residual pesticides if the land was farmed. If the land to be leased was used earlier as a gas station,

public records will be scrutinized and additional information obtained in an attempt to determine whether the site was properly closed and a 'no further action' letter issued. If the site is currently being operated as a gas station, issues arise as to the protection of the new operator from liability for contamination caused by the current operator, and a tri-party agreement including both operators and the property owner may have to be negotiated in order to establish a fair allocation of liability among the parties.

2. Operational Issues During the Term. The operator will agree in the lease to conduct its operations in accordance with governmental requirements regarding conditions determined to have resulted from the operator's operation of the motor fuels facility. The underscored qualification is necessary to afford protection from liability for migrating contamination and from acts of vandalism. The acts of third parties (i.e. parties not under the operator's control) can be addressed through insurance. Similarly, the operator's indemnification of landlord should be limited to the losses suffered by landlord stemming from third party claims. The concern here is to preclude a 'diminution of value' claim by landlord at the end of the term. Such a claim would allow landlord to sue the operator at the end of the term for the difference between (a) the current value of landlord's land given the prior use as a motor fuels facility, and (b) what the current value would be had landlord's land been used for another, non-environmentally hazardous retail use. This would provide for liability on the operator's part even if the operator was at all times in compliance with the requirements of both the lease and applicable laws during the term.
3. End-of-Term Issues. There are two major issues arising at the end of the lease term when motor fuels have been sold from the property: (a) what happens to the underground storage tanks, lines, dispensers, islands, canopies and other motor fuels equipment; and (b) end-of-term remediation standards.
 - a. Motor Fuels Equipment. Landlords are often interested in having the equipment remain on-site, the idea being to quickly lease the property to another motor fuels facility operator at a higher rent, given the presence of the equipment. The operator may well be concerned about potential future liability for conditions it did not cause if the equipment is left in the ground. First of all, it is difficult to clearly establish compliance with current remediation requirements if the tanks are left in the ground because the most likely spot to encounter contamination is directly under the tanks. Secondly, the next operator will always be tempted to draw the prior operator into a lawsuit and claim that the prior operator is at least partially responsible to remediate the contamination at the

site, and the prior operator will be required to spend time and money to extract itself from the lawsuit. These concerns have led a number of national c-store operators to require the right to remove the motor fuels equipment at the end of the term.

- b. Remediation Standards. In what condition is the operator to leave the property at the end of the term? Where the operator has agreed to comply with governmental requirements regarding conditions resulting from its operations throughout the term, it makes sense for the operator to remediate the property in accordance with all regulations applicable to the conditions caused by its operations at the end of the term. This is not the same thing as returning the property to the condition existing at term commencement, nor is it the same thing as remediating the property to a standard suitable for any lawful use, such as residential or child-care facility standards. Once property has been used for the retail sales of motor fuels, it will not regain its prior, pristine condition without exorbitant expense being incurred to remove every last particle of contaminated dirt, and no rational operator will agree to be held to that standard. To the extent that compliance with end-of-term remediation requirements takes some time to complete, the parties may agree to the operator paying landlord a fee in proportion to the extent that the operator's continuing presence on the property interferes with landlord's efforts to relet the property. The remedial measures should be deemed complete when the applicable regulatory authority issues a 'no further action' or 'closure' letter indicating that the authority will not require further remedial measures. Given the difficulty in obtaining that letter, the operator may convince landlord to accept in its place a verification by a licensed consultant that all remedial measures contained in a remediation plan approved by the regulatory authority have been performed by the operator or on its behalf.