

SIMON V. STARBUCKS - BIG BOY COURT CASE - WARMS MY HEART!

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THE DISPUTE

On August 21st, Simon Property Group filed a lawsuit that challenged Starbucks' decision to close 78 Teavana stores that are located in Simon malls. Starbucks announced recently their intention to close all 379 Teavana locations within the next year.

We have not seen the terms of the leases, but no doubt they are iron clad in terms of Starbucks rental obligations, no doubt at top dollar rents, with productive locations within Simon developments. I have not read anywhere that Starbucks does not intend to honor their rental obligations, including rents and common area charges. They will no doubt pay out hundreds of millions of dollars in the process of closing 379 stores. Fortunately, with quarterly cash flow from operations of \$1 billion, and growing, they can afford mistakes of this magnitude, and Simon will get their rent due, early in fact.

Simon's suit contends that Starbucks would be "shirking its contractual obligations at the expense of Simon's shopping centers." Apparently, in an effort to broaden the lease terms dealing with "covenant to operate", Simon says Starbucks must keep the stores open for the term of the lease whether they are making money or not. It wouldn't "look good", would be damaging to the mall, Simon implies, if a fairly prominent store location is vacant. Simon seems to forget that, once notified that the store is closing and the rental obligation is paid out (which there is every expectation that Starbucks will do), the space can be rented again, actually improving the overall return on Simon capital investment. The new tenant can't do much less business than Teavana is doing (or Starbucks wouldn't be leaving), so traffic will improve from the current disappointing situation. Simon, however, will try to argue that the Teavana store was an "attraction" for mall shoppers, so Simon is damaged when that traffic pattern is disturbed. I wonder if Simon gave Starbucks a rent concession because of that traffic building appeal which both parties expected would be a benefit to all tenants and the success of the mall. I've been part of lease negotiations with major mall developers and have found that it tends to be a one way street. It is no doubt different for Starbucks than for Joey's Pizza (generically speaking) because Starbucks' lease is "bankable" and Starbucks can get the good location it wants, still though at top dollar rent. Poor Joey will only get a good location, also of course at top dollar, if he takes two bad ones elsewhere. Put the three locations together and Joey will barely break even. The mall developers seem almost uncanny in their ability to understand these economics, exactly what rent will allow the tenant to work almost entirely for the landlord.

UNFORESEEN CONSEQUENCES

Sometimes bad stuff happens, even with the best of intentions. An architect has an omission in his building plans, changes have to be made on the fly, the end user pays, there is no recourse to the architect. A mall tenant signs a lease, takes occupancy on time, but the mall doesn't get completed and/or fully occupied for many months, perhaps never. Does the tenant get a concession from Simon (in this case)? Not likely. The hamburger QSR chain signs a top dollar lease in the food court, and is (by the terms of the lease) the "exclusive" hamburger provider, but Nathan's Famous Hot Dog's moves in (for example), also has a pretty good hamburger. Does the mall operator do anything about it? Not likely? The retail tenant on 2nd Avenue in New York City signs a twenty year lease (at top dollar), and the City spends 10 years building the new subway line, with traffic disruption bankrupting retailers. Bad luck. A snowstorm of historic proportions puts mall traffic at a standstill on the weekend before Christmas when retailers make their profit for the year. Simon gets their rent; the retail operator has coal in its stocking.

CONCLUSION

Simon Properties, and other major mall developers, have had their day in the sun for forty years. It's been "their way or the highway".

To Starbucks I say: You gave it your best shot, you are paying the price. **Move on.**

To Simon Properties I say: **GROW UP!!**