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LAW REPORT

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From Clicks to Bricks

"Clicks to Bricks" is the catchy industry phrase for online retailers opening up brick-and-mortar operations. The International Council of Shopping Centers: ICSC reports, "More online retailers say they plan to explore the brick-and-mortar channel……Several online brands, including BaubleBar, Bonobos, JustFab and Warby Parker, have invested in brick-and-mortar operations in recent years. Perhaps this is no wonder: In-store conversion rates continue to be four times higher than online-only conversion rates…. Consumers still prefer in-store shopping." (SCT, June 2015).


J.J. Sherman

In many ways, a retail lease for an online brand is no different from the traditional retail lease. However, there are some specific places where both the tenant and the landlord will seek to tailor the retail lease to the online brand's business.

Best Practices for Retail Leases for Online Brands Opening up Brick-and-Mortar Locations:

1. **Percentage Rent on Internet Sales.** Retail leases require the tenant to pay the landlord not only a fixed minimum rent sufficient to give the landlord a reasonable return on its investment, but also a percentage rent based on the gross sales generated from the tenant's business at the leased premises. Percentage rent is calculated as a fixed percentage of the tenant's gross sales at the leased premises, and is payable to the landlord once an annual sales threshold is reached, or sometimes from the first dollar earned. What is included in or excluded from the definition of "gross sales" is highly negotiated, and this point is particularly important to e-commerce brands. As the tenant, be sure to limit the definition of "gross sales" to those sales coming out of the four walls of your store and expressly carve out all internet sales not placed from or filled at the store. Be aware that your landlord may try to broaden the definition of "gross sales" to include internet sales placed from, filled at, or delivered to any location within a radius of your store, or within certain zip codes. Especially if you use your store primarily as a showroom where customers examine merchandise, and later buy goods online, your landlord may seek to include some internet sales placed or filled outside of the four walls of your store in "gross sales" for purposes of percentage rent.

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2. **Returns on Internet Sales.** In this multi-channel shopping world, customers increasingly purchase goods online and return them at stores. As a tenant, be sure to exclude from the definition of "gross sales" the sales price of all merchandise returned by customers and accepted for credit. Don't be surprised if the landlord does not exclude from "gross sales" refund credits for sales that originated from internet sales, or seeks to cap the exclusion to no more than 1% or 2% of "gross sales" in a calendar year.
3. **Permitted Use.** Unlike the traditional retailer that carries inventory in a store for immediate purchase, some online retailers use their stores primarily as a showroom and carry no inventory on-site. This strategy allows for a more efficient footprint. Other online retailers adopt a hybrid approach. They have a showroom and carry limited inventory on-site. Still other online retailers follow the traditional approach, with full inventory available for purchase at their stores. As the tenant, remember that your business plan may change over time, and make sure that the use clause in your retail lease permits you not only to sell your retail merchandise, but also to operate as a showroom for the display of your brand's retail merchandise. ◆

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IN THIS ISSUE:

Online Influencer Campaigns for Retailers

Retailers partner with social media influencers – individuals that have a wide online following in niche subject matters such as fashion, beauty and food – with great success, and the press is noticing. According to *Adweek*, "Lord & Taylor scored a social media coup with an Instagram blitz that had 50 fashion influencers wearing the same dress, which sold out right away." (AdWeek, April 3, 2015). This very same Instagram campaign raised eyebrows for another reason: Despite the fact that Lord & Taylor provided Instagram influencers with the dresses and an undisclosed amount of compensation, neither Lord & Taylor nor its content partners disclosed to followers that this was a promotional campaign.

Coincidentally, soon after the Lord & Taylor Instagram Campaign, the Federal Trade Commission (FTC) published guidance for online advertising in May 2015: "The FTC's Endorsement Guides: What People Are Asking."

As a matter of background information, the FTC Guidelines Concerning the Use of Endorsements and Testimonials, which applies to all media, preach three basic truth-in-advertising principles: (1) Endorsements must be truthful and not misleading; (2) If the advertiser doesn't have proof that the endorser's experience represents what consumers will achieve by using the same product or service, the advertisement must clearly and conspicuously disclose the generally expected results in the depicted circumstances; and (3) if there is a connection between the endorser and the marketer of the product or service that is likely to affect the weight or credibility given to the endorsement, the connection must be disclosed. The FTC defines an "endorsement" as any advertising message (oral or written) that consumers are likely to believe reflects the opinions, beliefs, findings or experience of a party other than the sponsoring advertiser, even if the views expressed by that party are identical to those of the sponsoring advertiser.

Here are some questions that might arise over the course of an Online Influencer Campaign – on Instagram or otherwise - and some guidance from the FTC:

Question 1: If an Influencer mentions a product in a post, does she have to say whether she got it for free or whether she got paid to mention the product? According to the FTC, the FTC is only concerned with endorsements that are made on behalf of a sponsoring advertiser. If an advertiser, or someone working for the advertiser, pays the Influencer or gives her something of value to mention a product in a post, the mention would be considered an endorsement. If the Influencer receives free products or other perks with the expectation that she'll promote or discuss the advertiser's products in her posts, the FTC Guidelines apply.

Question 2: Does an Influencer actually have to say something about a product for a post to be considered an endorsement? Do pictures count? According to the FTC, yes. As the saying goes, "a picture is worth a thousand words." The simple act of posting a picture of a product in social media, such as on Instagram or Pinterest, or a video of the Influencer using it, could convey that the Influencer likes and approves of the product. If that's the message, it's an endorsement. If an Influencer posts a picture of a product and she has a relationship with the company marketing the product, adequate disclosure is required.

Question 3: An Influencer uploads a video on YouTube where she reviews several products. Does she need to disclose the products were received from an advertiser? According to the FTC, yes. Videos are treated the same as websites or blogs.

Question 4: As part of a paid campaign, may a popular Influencer click a "like" button, pin a picture, or share a link to show that she is a fan of a particular business, product, website or service? According to the FTC, using these features to endorse products or services as part of a sponsored brand campaign probably requires disclosure. The FTC recognizes that some platforms – like Facebook's "like" buttons – don't allow the Influencer to make a disclosure, and adds that advertisers shouldn't encourage endorsements using features that don't allow for clear and conspicuous disclosure of the relationship.

Best Practices for Influencer Endorsements in Social Media:

1. **Teach your Influencers** to adequately disclose that they received payments, products or perks in exchange for their endorsements.
2. **In your agreements, remind your Influencers** that Federal guidelines on endorsements in social media require disclosure that they are working with you on a marketing campaign. Require your Influencers to use disclosure in each post, such as: "Ad:," "#Ad," #Sponsored," "Paid," or "I partnered with this brand." The disclosure needs to appear in a clear and conspicuous place in each post. It can't be hidden at the end of a post or hidden next to any link.
3. **Take reasonable steps to monitor** your Influencers' compliance with the Federal guidelines. ◆

Co-Tenancy Provisions in California Leases

In 2015, in *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.*, 232 Cal. App. 4th 1332 (2015), the California Fifth Appellate District Court ruled on the enforceability of co-tenancy provisions in commercial leases. This case has garnered the attention of the California real estate bar, since it's the first time the enforceability of this type of provision has been addressed in a published California appellate court case.

Co-tenancy provisions in retail leases are tenant-friendly provisions requiring either that (a) a minimum proportion of the floor space in a shopping center is open and operated by other tenants or (b) specifically named tenants be located within and operating in a shopping center. If the overall percentage of tenants open and operating falls below the requisite level, or if the named tenants are not open and operating in the shopping center, then the co-tenancy provision will be breached and the retail tenant may be entitled to remedies spelled out in the lease. Co-tenancy clauses come in two forms: Opening co-tenancy requirements are conditions that must be met before a tenant is obligated to open for business or to pay rent. Operating co-tenancy requirements are conditions that must be met during the term of the retail lease, and if the condition fails during the term, the tenant's obligation to operate or to pay rent may be terminated or reduced according to the lease.

In *Grand Prospect Partners*, the landlord reached out to Ross Dress for Less, Inc. to see if Ross would like to lease vacant space in the Porterville Marketplace in Porterville, California. A final letter of intent was executed, and a final lease was signed. The lease contained both an opening and operating co-tenancy clause. The opening co-tenancy clause required Mervyn's to occupy not less than 76,000 square feet of leasable floor area, and Target to occupy not less than 126,000 square feet of leasable floor area as of Ross's commencement date. Additionally, the lease required 70% of the leasable area of the shopping center to be occupied by operating retailers. If the opening co-tenancy condition was not met, Ross would not be obligated to pay rent and the landlord would have 12 months to cure, after which Ross would have the right to terminate the lease.

Mervyn's filed for bankruptcy and shut its doors before Ross's commencement date. Relying upon the opening co-tenancy provision, Ross did not open its store and did not pay rent, even though it did accept possession. After the 12 month cure period elapsed, Ross terminated its lease. The landlord sued, arguing that the co-tenancy provisions were unenforceable, and that the landlord was entitled to damages for unpaid rent, future rent for the entire term, and reimbursement of tenant improvement expenditures.

The appellate court found the co-tenancy provisions to be valid and enforceable, based on the high level of sophistication of both parties and the fact that the letter of intent and lease were heavily negotiated. Similarly, the court upheld the tenant's termination right. However, the court did determine that the tenant's right to rent abatement during the 12 month cure period was unenforceable as a penalty against the landlord, since the value of rent forfeited bore no reasonable relationship to the anticipated harm to Ross.

In *Grand Prospect Partners*, a California appellate court upheld co-tenancy provisions in a commercial lease for the first time in a published opinion. The opinion does not establish a categorical rule of law holding co-tenancy provisions always, or never, are enforceable. Instead, the case is fact specific and is premised on the sophistication of the landlord and the tenant. After *Grand Prospect Partners*, co-tenancy provisions may be enforceable in California if the facts are right, but a tenant must take care that any rent abatement remedy is reasonably related to the tenant's expected losses in the event of a breach of the co-tenancy provisions. ◆

FIRM NEWS

KickFannie!
J.J. Sherman is a legal contributor to KickFannie, a leading business development web source located at *www.kickfannie.com*. Check out her articles under "KickFannie's LegalEdge with J.J. Sherman."

10 Things Every Founder Should Know!
J.J. Sherman was a featured real estate speaker on the "Start Up Law" Panel sponsored by Cyrus Innovations on June 30, 2015 in New York City.

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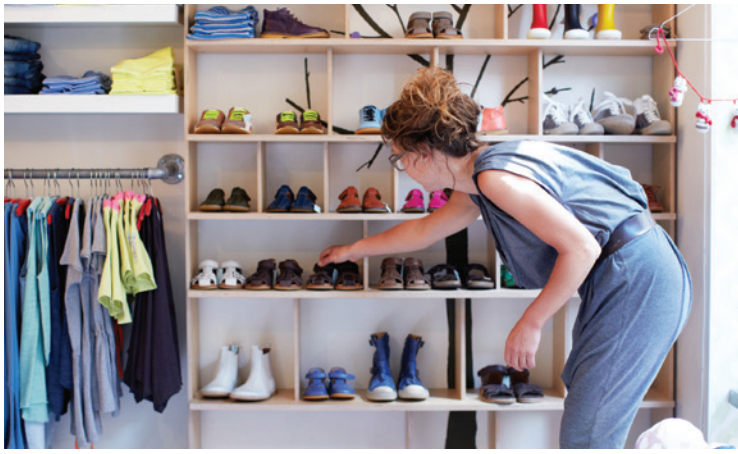
Use Clauses 2.0

Retail landlords choose retail tenants based on the tenants' brands and merchandise, and based on an assumption that the majority of the rentable square feet in the store will be used for the display of tenant-branded merchandise. That assumption is not always true. Retailers who seek to capture consumers' preference for "experiences" over "acquisitions" are reinventing themselves and designing stores where incidental uses may take up a sizable amount of rentable square feet.



In the October 2015 article, "If You Spend Longer, You Spend More", the *Wall Street Journal* reports on a retail trend known as slow-shopping: "To entice shoppers to spend more time, boutiques and national chains are adding libraries, art installations, performance spaces and cozy lounges to encourage shoppers to hang around and enjoy themselves." Stores display more than merchandise to keep shoppers in their stores.

During retail lease negotiations, if you are a tenant, consider whether your brand will undergo a "conceptual redesign" over the term of your lease, and build flexibility into your use clause. Without some pre-approved flexibility to add incidental uses, your landlord may not be sympathetic to a subsequent amendment to the use clause if it believes it will affect the dollars per square foot calculation or the reputation of the center. In addition, be sure to check that existing tenants in the shopping center do not have exclusive use rights that may restrict your proposed uses. ◆