

Applying Reciprocal Easement Agreements to Retail Projects

RECIPROCAL EASEMENT AGREEMENTS (REAs) are commonly used in retail development when neighboring property owners want to develop their respective properties as one integrated shopping center. Often when more than one owner develops a shopping center, one of the owners acts as developer and the other is a major retailer (for example, Target, Wal-Mart, Home Depot, or Kohl's). Although the developer may lease a portion of the property to the major retailer (in which case an REA will not necessarily be warranted, since the lease will provide for construction, operation, and management), if the retailer desires to purchase a portion of the property, it will be necessary for the developer and the major retailer to enter into an REA. It is used to detail the parties' contractual agreement on such things as the construction of the shopping center, the architectural compatibility of the buildings, the use of the common area, and restrictions on use.

Many of the parties' respective rights, as detailed in the REA, are considered easements,¹ since they effectively allow one party nonexclusive use² of the property of the other. The REA is usually a recorded document,³ and the contractual obligations set forth in the REA typically run with the land⁴ of the property encumbered by it. Without an REA, the major retailer (or developer) could potentially build whatever it desired whenever it desired; prevent the developer from using any part of the major retailer's parcel for parking, access, or utility lines;⁵ or put its space to an incompatible use.

In this regard, an REA may be viewed as taking the place of a lease and the rights and obligations it typically sets forth between a developer and a major retailer. However, in most cases the major retailer will not view the two as being the same. The major retailer may view its ownership of a portion of the shopping center as giving it greater rights and fewer obligations than a lease. For example, a major retailer may want the unilateral right to lease its property to any other user following its acquisition of a portion of the shopping center, whereas if it leased the property, it would most likely allow the developer landlord the right to consent to certain assignments or sublets. However, without an REA that contains many of the same provisions normally contained in a lease, the operation of a shopping center that many parties own may be chaotic and ineffective.

To avoid the problem of having too many parties running a shared property, a typical retail REA sets forth many issues affecting the developer and retailer. An REA may be a two-party agreement (e.g., between the developer and the major retailer) or involve three or more parties (e.g., between the developer and multiple retailers). In addition, an REA may be between nonretailer property owners that want to jointly develop their respective properties for retail or other purposes (e.g., industrial, warehousing, or office). This type of REA is less common and deals with some but not all of the same issues that are usually covered in an REA between a developer and a major retailer. The typical two-party REA between a developer and a retailer addresses, among other things: 1) easements for parking, access, encroachments, and utilities, 2) construction and architectural compatibility, 3) operation of common areas, 4) taxes, building

maintenance, and building insurance, 5) use, recapture rights, and rights of first offer, 6) covenants running with the land, term, and amendments, and 7) mortgagee protection provisions.

Parking, access, encroachments, and utilities. The REA should provide both parties with at least the most basic rights for their respective properties, so that they may be operated in harmony. Each party should have the right to access the other party's property for vehicular parking and pedestrian access. For instance, the customers and employees of the major retailer (and operators on the developer's property) will need the right to park anywhere they want within the shopping center (subject to an agreement by the parties to provide special areas for employee parking) and to walk anywhere they want within the shopping center. Customers of the occupants of the shopping center should view the property as being owned by one party and operated as a fully integrated shopping center (even though the property is owned by two or more different parties). Each party may also need the right to connect to the other parties' utility systems (typically the major retailer ties into the developer's utility systems for the shopping center). This enables utilities to be brought to each occupant's premises by using another party's utility mains or conduits and avoiding duplication of facilities and work. The parties may also need certain encroachment rights if their canopies or foundations minimally encroach upon the other party's property.

Construction and architectural compatibility. The REA will typically require that the developer construct all the on- and off-site improvements for the shopping center, as well as the buildings to be located on the developer's property. Similarly, the REA will commonly require the major retailer to be responsible for the construction of its building. The REA will typically provide rights for a party to review and approve the plans and specifications of the other party's work, thereby creating a way to ensure architectural compatibility for the construction work. In addition, the REA will often require that each party construct its improvements pursuant to a mutually approved construction schedule. Depending on the nature of the deal, the REA (or a separate development agreement) will require that the major retailer reimburse the developer for an equitable share of the costs incurred by the developer to construct the shopping center's on- and off-site improvements.

Operation of common areas. The REA should require that at least one party operates, insures, and maintains the common areas of the shopping center.⁶ The party with this responsibility is usually the developer or a third-party manager appointed by the developer. The manager should be obligated to keep the common areas in a neat, clean, and attractive condition, and then to charge the parties to the REA for their respective prorated shares of common area costs. If the

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developer does a poor job operating and maintaining the common area, the major retailer often has the right to take over the operation and maintenance of the common areas located on its property, although sometimes this takeover right may apply to the entire common area in the shopping center. Instead of one party being responsible for the operation of the common areas, sometimes an REA will provide for each party to be responsible for its own portion of the shopping center. Again, in this case, the REA should require that such operation and maintenance meet certain standards of quality, failing which the other party will have certain well-specified remedies.

Taxes, building maintenance, and building insurance. REAs usually require each property owner to pay the property taxes that relate to its respective property. In addition, each party is typically required to maintain the appearance of the buildings on its property in an attractive manner. Each party may also be required to maintain first-party insurance on the buildings located on its property (note, however, that in the event of a casualty, each party is usually given the right to raze the building improvements located on its own property or to rebuild them to their former condition). Regardless of a party's responsibility for buildings on its property, most REAs require that common area improvements located on a party's property be rebuilt following a casualty. Although this obligation is typically the responsibility of the developer, in some cases it may be the responsibility of each property owner.

Use, recapture rights, and rights of first offer. Some REAs may require the major retailer to use its property for a particular use or, in turn, restrict uses on the developer for the benefit of the major retailer.⁷ In the event that the major retailer is required to make a particular use of its property and ceases to do so for a specified period (usually six months, but often subject to extension for remodels, casualties, or other events outside the control of the major retailer), the developer may be given the right to purchase the major retailer's property for its fair market value or other negotiated price. In theory, this gives the developer the right to control its real estate or to lease or sell the major retailer's property to a user that will use its property for a retail use compatible with the remainder of the shopping center. The REA may also provide that in the event that either party desires to sell its property to an unaffiliated third party, the other party will have, for a short time, a right of first offer to purchase the selling party's property. In other words, the selling party has an obligation to undergo good faith negotiations with the other party to the REA before selling the property to the unaffiliated third party. If either a right to purchase

or a right of first offer is contained in the REA, the buying party should be required to pay a price that is agreeable to both parties. In the event that the parties are unable to reach an agreement on price within a short time, the party desiring to sell its property would have the right to sell it to the unaffiliated third party. However, the REA may require the selling party to again offer the property for sale to the other party if it is unable to sell the property within a specified time for a price equal to or greater than 95 percent of the purchase price offered by the other party.

Covenants running with the land, term, and amendments. The REA should specifically provide that the rights and obligations set forth in the REA run with the land of the property subject to the REA.⁸ In other words, the entity owning the property that is subject to the REA will be subject to the terms and provisions set forth in the REA. In addition, the REA should specifically provide for the term of the REA and the method by which the REA may be amended.⁹ The REA should provide that the easements necessary for a party to access the public streets surrounding the shopping center and to use the shopping center utility systems run in perpetuity. This will most likely be required by the governing body with jurisdiction over the property as a condition to the recordation of the subdivision map creating the parcels that are subject to the REA. In some REAs, the parties agree that the easements for parking will run in perpetuity. Typically, the REA cannot be amended without the approval of the developer and the major retailer. However, the REA should be clear as to which parties have this approval right if one party's property is subsequently subdivided into multiple properties or owned by multiple parties.

Mortgagee protection provisions. The REA should contain provisions for the benefit of the lender of each party to the REA. In the event of a default by one party to the REA, the nondefaulting party should be obligated to notify the defaulting party's lender (to the extent it has been given notice of the lender) and allow the lender to cure the default. In addition, the REA should provide that a breach of any of the covenants or restrictions contained in the REA will not defeat or render invalid the lien of any lender made in good faith and for value as to the shopping center or any part thereof.¹⁰

Shopping center REAs are understandable when they are viewed as a substitution for the operational provisions of a lease between a developer and a major retailer. Although an REA will not contain the same types of provisions found in a lease, many of the concepts are the same. As with a lease, the REA ensures that the developer's property and the major retailer's property are operated as

one integrated shopping center so as to maximize the success of the shopping center for all parties and to avoid waste and inefficiencies. ■

¹ An easement is a nonpossessory interest in the land of another that gives the owner of the easement the right to use the land of the other person or to prevent the other property owner from using the land. *Mehdizadeh v. Mincer*, 46 Cal. App. 4th 1296, 1306 (1996). The extent of an easement is determined by the terms of the grant in the REA. CIV. CODE §806. When an easement is founded on a grant, only those interests expressed therein and necessary for its reasonable and proper enjoyment pass from the owner of the fee. *Pasadena v. California-Michigan Land & Water Co.*, 17 Cal. 2d 576, 579 (1941).

² An easement is nonexclusive unless expressed otherwise. An exclusive easement is unusual as it almost amounts to a conveyance of the fee. *Keeler v. Haky*, 160 Cal. App. 2d 471, 474-75 (1958).

³ For the contractual obligations (or covenants) contained in an REA to run with the land and be binding on successive owners, the REA must be recorded in the Office of the Recorder of each county in which the land is situated. CIV. CODE §1468(d).

⁴ Civil Code §1460 defines covenants running with the land as "certain covenants, contained in grants of estates in real property, [that] are appurtenant to such estates, and pass with them, so as to bind the assigns of the covenantor and to vest in the assigns of the covenantee, in the same manner as if they had personally entered into them."

⁵ Easements expressly created through an REA should be restricted to the specific, limited, and definable use or activity contemplated by the parties because the extent of the easements are determined by the terms of the grant or the nature of the enjoyment by which it was acquired. CIV. CODE §806.

⁶ The owner of the property burdened by the easement has no obligation to maintain or repair the easement unless the parties enter into an agreement that alters their legal responsibilities and imposes an obligation of maintenance on the servient tenement owner. *Herzog v. Grosso*, 41 Cal. 2d 219, 228 (1953). The owner of an easement has the statutory duty to maintain and repair the easement. CIV. CODE §845.

⁷ Also known as an exclusive use provision, this is essentially a covenant not to permit other occupants of the shopping center to operate a business that would compete with the business of the major retailer. For case law discussing the legality of such limited constraints on trade, see *Great Western Distillery Prods., Inc. v. Wathen Distillery Co.*, 10 Cal. 2d 442, 448-49 (1937); *Martikian v. Hong*, 164 Cal. App. 3d 1130, 1134 (1985); *Borman, Inc. v. Great Scott Super Markets, Inc.*, 433 F. Supp. 343, 349-51 (E.D. Mich. 1975); and *Optivision, Inc. v. Syracuse Shopping Center Assocs.*, 472 F. Supp. 665, 674-81 (N.D. N.Y. 1979). See also Jeffrey N. Brown, *Use Provisions in Commercial Leases*, LOS ANGELES LAWYER, Jan. 2006, at 21.

⁸ The requirements for the covenants in the REA to run with the land are set forth in Civil Code §1468.

⁹ As a general rule, restrictions on land may be amended or terminated by the execution of a mutual agreement signed by all the property owners subject to the restrictions. RESTATEMENT (FIRST) OF PROPERTY §557. However, the parties may also agree to an expiration date or modified procedures in the REA.

¹⁰ For sample mortgagee protection provisions in the analogous area of landlord-tenant retail leasing, see Gary Glick, Estelle Braaf & Tamar Stein, *Default and Remedies*, in RETAIL LEASING—DRAFTING AND NEGOTIATING THE LEASE §27.55-27.56, 777-79 (CEB 2007).