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A PERCENTAGE LEASE is one which states a minimum rental, and, above that, an additional rental based upon a stated percentage of gross sales.[1] The litigation posing the most difficulty in the area of percentage leases involves the right of the lessee to vacate the premises.[2]

There are several reasons why a percentage lessee might want to abandon the leased premises before the expiration of the lease. First, he may have a very successful venture and wants to increase its success by lessening or eliminating the percentage of his sales that must be paid to the lessor. Thus, he might abandon the premises in favor of a nearby location with a more economically favorable lease. Second, the lessee might be attempting to avoid a losing venture. His sales volume might be quite high which, of course, would entitle the lessor to a large percentage rent. But, the cost of operations might be so high that maintaining that level of sales would mean sustaining losses.[3]

The cases involving the lessee's abandonment of the premises before the expiration of the lease can be divided into two basic categories. The first group of cases involves leases in which there is no minimum rental, or, in which the minimum rental was so low as to be nominal. The second group involves leases which provide for a substantial minimum rental.

In those cases involving a nominal rent, the courts have been consistent in inferring a covenant by the lessee to remain in possession of the premises, and, to continuously operate his business as originally envisioned when the lease was executed. It has always readily been seen by the courts that the percentage provision of the lease was meant to provide the substance of the rent. Allowing the lessee to abandon the premises would be allowing the lessee to simply stop paying rent. This, of course, would defeat the purpose of the lease and could not be tolerated.[4]

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1 Friendly Center, Inc. v. Robinson, 233 F. Supp. 274 (D. C. N. C. 1954); Hemingway, Selected Problems in Leases of Community and Regional Shopping Centers, 16 Baylor L. Rev. 1 (1964).

2 Notes, Resolving Disputes Under Percentage Leases, 51 Minn. L. Rev. 1139 (1967).

3 Comments, The Lessee's Obligation Under a Percentage Lease, 60 Nw. U. L. Rev. 677 (1965).

4 Report of Committee on Leases, Am. Bar Assoc., Drafting Shopping Center Leases, 2 Real Prop., Prob., and Trust J. 222 (1967).

Court decisions have not been as consistent in those cases involving a substantial minimum rental. It is in this area that a very interesting trend is developing. Until recently, most courts held that, in this situation, the parties did not intend that the lessee should be under an obligation to continuously operate his business on the premises. They seemed to reason that the substantial guaranteed minimum rent assured the lessor of a fair return from his property, and, that the percentage was merely intended to be a bonus or windfall should the business be successful.[5]

Some recent decisions, however, indicate that the courts are becoming more willing to closely examine the circumstances surrounding execution of the lease in an effort to determine whether the parties themselves considered the substantial minimum rent to be an adequate return to the lessor.[6] This trend is occurring concurrently with changes which are taking place in the circumstances surrounding store leases. Most new store construction today is taking place in the form of shopping centers, and, the percentage lease is the rule, rather than the exception, in the modern shopping center lease. The exact percentage is negotiated between lessor and lessee with as much importance as the minimum rental. The percentage rental has become something other than a "mere windfall," and, in fact, has become almost as much the substance of the lease as the minimum rental. Therefore, this trend in the courts today is a realistic appraisal by the courts of the context in which the modern percentage lease is negotiated.

The specific legal issue confronting the courts in all percentage lease cases is whether an implied covenant not to deprive the lessor of his percentage rent should be attributed to the lessee.[7] As mentioned above, in those cases where the minimum rental was so low as to be nominal, or, where there was no minimum rental, a covenant to continuously operate, and, thereby, not deprive the lessor of his percentage rent has consistently been implied. The courts have remained consistent in this area.[8]

For example, in *Sinclair Refining Co. v. Davis*,[9] the premises were leased for a service station. The rental was based upon the gallonage sold at the station with a minimum rent of ten dollars per month. The lessee stopped selling gasoline on the premises, but continued to occupy the premises.

The court said that it was clearly within the contemplation of the parties to the contract that the lessee would continue to sell gasoline

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5 Notes, *op. cit. supra* n. 2.

6 *Id.*

7 Comments, *op. cit. supra* n. 3.

8 Report of Comm. on Leases, Am. Bar Assoc., *op. cit. supra* n. 4.

9 47 Ga. App. 601, 171 S.E. 150 (1933).

throughout the term of the lease. Failure to sell gasoline was a breach of the lease in a matter so substantial and fundamental as to defeat the object of the lease. The court ruled that the lessor could collect from the lessee a sum of money equal to the fair rental value of the premises.[10]

Similarly, in *Lippman v. Sears Roebuck & Co.*,[11] the lessee had a lease which provided for a rental equal to the greater amount of a stated percentage of sales or a minimum. The lease contained a clause which stipulated that the use of the premises would be for the sale and storage of general merchandise, and for servicing automobiles, tires, batteries, and accessories. The lessee moved the retail operation to a new location before the expiration of the lease. Then, he used the premises solely for storage, and tendered the minimum rental.

In this case, the facts showed that the minimum rental was a nominal amount. The lessor had repaired and remodeled the building at a substantial cost. These expenditures were made with the understanding that the lessor would gamble with the lessee on the amount of retail sales. Later improvements were made by the lessor without any charge to the lessee in anticipation of increased overages resulting from increased sales.[12]

In *Lippman*,[13] the court said that the base rent was not a substantial or adequate minimum rental and, therefore, the lessee impliedly covenanted to continue selling merchandise in the premises for the duration of the lease. The lessor received damages based upon overage rentals paid in previous years by the lessee at that location.

Recent decisions have continued to follow this policy. For example, in 1964, a Massachusetts court noted that if the minimum rent in a percentage lease is significantly below the fair rental value of the property, then the conclusion can be reached that the parties intended that the lessors would have the benefit of the percentage rent throughout the term of the lease.[14]

The position of the courts is clear in these cases involving a percentage lease with a nominal guaranteed minimum rent. Courts have consistently ruled, in this situation, that the lessee's vacating of the premises constituted a substantial breach of the lease, and made the lessee liable for damages to the lessor.[15]

This situation differs, however, from that involving a percentage lease with a substantial guaranteed minimum rental. In the past, the

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[10] *Id.*

[11] 44 Cal. 2d 136, 280 P. 2d 775 (1955).

[12] *Id.*

[13] *Id.*

[14] Stop & Shop, Inc. v. Ganem, 347 Mass. 697, 200 N.E. 2d 248 (1964).

[15] Sinclair Refining Co. v. Gliddens, 54 Ga. App. 69, 187 S.E. 201 (1936); Sinclair Refining Co. v. Davis, *supra* n. 9; Lippman v. Sears Roebuck & Co., *supra* n. 11.

courts have allowed the lessee greater leeway, in this situation, with respect to the use and occupancy of the premises.[16]

One decision which clearly shows the court's position in the strict interpretation of a percentage lease is *Cousins Investment Co. v. Hastings Clothing Co.*[17] In this case, the lessee vacated the leased premises two months before the expiration of the lease term, and, paid the minimum rental for those two months. The lessor brought action to recover the additional percentage rental that he would have received if the tenant had remained on the premises operating his business until the expiration of the lease.

The court held that there was no implied covenant that the tenant would operate its business in the demised premises throughout the term of the lease. It reasoned that the terms of the agreement were clear, definite, and unambiguous, and that there were no grounds to support an implied covenant.[18]

The court further stated that covenants should be implied only (1) where the implication must arise from the language used or was indispensable to effectuate the intention of the parties, and, (2) where it appears from the language used that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it. Furthermore, the court noted that there can be no implied covenant where the subject is completely covered by the contract.[19]

Although the court in *Cousins* followed a theory of strict interpretation, they did leave some room for intent where the intent was very clear. In the 1938 case, however, of *Jenkins v. Rose's 5, 10, and 25¢ Stores,*[20] the court was even stricter in their interpretation of the lease. They were dealing with a similar set of facts as *Cousins,* but, they ruled that even if one, or both, of the parties expected and intended that they would use the leased premises for a particular purpose, the tenant is still under no obligation to occupy or use the premises in the absence of a specific provision in the lease.

Courts in later years continued to apply a strict interpretation to the terms of the lease. In the 1958 case of *Monte Corp. v. Stephens,*[21] the lease provided that ". . . lessee agrees the leased premises is to be used only for the conduct of business in selling baby and children's wear, clothing and related items." The rental was the greater of a guaranteed minimum or a stated percentage of gross income. The lessee abandoned the premises before the expiration of the lease term, and the new tenant

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16 Annot., 170 A.L.R. 1117 (1947).

17 45 Cal. App. 2d 141, 113 P. 2d 878 (1941).

18 *Id.*

19 *Id.*

20 213 N.C. 606, 197 S.E. 174 (1938).

21 324 P. 2d 538, 539 (Okla. 1958).

paid the lessor slightly more than the base rental for the balance of the lease. The lessor brought action to recover the difference between the amount tendered by the new lessee, and the amount that the original lessee had been paying based upon the percentage rental.[22]

In *Monte Corp.*,[23] the court held that there was no implied covenant that the tenant abandoning the premises before the expiration of the lease term was liable to the landlord for the difference between the rent received by the landlord from the subsequent tenant during the original term, and, the average rental which the first tenant had paid under the percentage lease.

The court also followed this line of reasoning in *Weil v. Ann Lewis Shops, Inc.*[24] The lessee was on a percentage lease with an adequate guaranteed minimum rental. Abandoning the leased premises before the expiration of the lease term, the tenant tendered only the guaranteed minimum rental. The lessor sued for the percentage rental. In a determination by the jury, it was found that both parties had intended that the lessee would use and occupy the premises as a ladies' ready-to-wear store. Nevertheless, on appeal, the court ruled that the lease was written in plain, clear, and unambiguous language, and, that its construction was a question to be decided by the court and not by the jury. The court held that the tenant was under no obligation of continuous occupancy and use in the absence of an express provision in the lease—regardless of the intent of the parties to the lease.

In the 1962 Ohio case of *Kretch v. Stark*,[25] the lessee stopped selling merchandise in the leased premises 2½ years before the expiration of the lease. The lease stipulated an adequate minimum rental and a percentage of sales. The court ruled that the lessee was not obligated to occupy and use the premises for any definite period of time, and it refused to infer any implied agreement or covenant to that effect. The tenant was only liable for the fixed minimum rental for the balance of the lease term.

Similarly, in the 1962 decision of *Stemmler v. Moon Jewelry Co.*,[26] the defendant had been on a percentage lease with an adequate guaranteed minimum. He vacated the store 1½ years before the expiration of the lease and built a new store in the area. The defendant continued to pay the base rental. The plaintiff sued for the additional amount above the base that would have been received if the defendant had continued to operate his business on the leased premises.

One of the lease clauses stipulated that the premises were to be leased ". . . for the sole uninterrupted use and occupation of said prem-

[22] *Id.*
[23] *Id.*
[24] 281 S.W. 2d 651 (Tex. 1955).
[25] 92 Ohio L. Abs. 47, 193 N.E. 2d 307 (1962).
[26] 139 So. 2d 150 (Fla. App. 1962).

ises by the lessee for the operation of a retail jewelry store." [27] Nevertheless, the court said that interpretation of the agreement must be based upon what is written, and that there was no affirmative covenant made by the defendant to operate a jewelry business on the leased premises.[28]

Recent decisions, however, have not been consistent with the holdings of these cases. In spite of past decisions which allowed the lessee to vacate and simply pay the minimum rental, the present trend in this area is to restrict the lessee's right to vacate the premises.[29]

In the 1964 case of *Simhawk Corporation v. Egler*,[30] the lease provided that the tenant would use the premises "only for the purpose of a shoe store engaged in the sale at retail of children's shoes and footwear." The rental was to be a base rent plus a stated percentage of sales in excess of a particular volume. The lessee vacated the premises before the expiration of the lease term to move into a new store, and tried to merely tender the base rental.[31]

The court ruled against the tenant, but it did not note any implied covenants. In fact, the court relied upon the use clause in the lease to show that the intent of the parties was clearly expressed by the language of the lease:

> The parties saw fit to include therein a provision that defendant in addition to the minimum rental would pay a percentage of the gross sale of shoes made in the shoe store conducted on plaintiff's premises. The source of the percentage rental was the shoe store and to insure its continued operation the lease specified that the defendant would use the premises only for such purpose.[32]

The lessee sought to introduce evidence showing that the minimum rental by itself represented a substantial return on lessor's investment, but this evidence was ruled to be immaterial. The court held that the failure of the lessee to continue operating a shoe store on the premises constituted a breach of the lease because the parties clearly intended that the rental should include a percentage of gross sales above a certain sales volume, and that to hold otherwise would be substituting a rental payment clause entirely different than that to which the parties agreed.[33]

As compensation for this breach, the court said that the lessor was due rent in excess of the base rent according to the expected sales of the lessee as could reasonably be expected judging from past sales while the premises were occupied.[34]

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27 *Id.* at 151.
28 *Id.*
29 Notes, *op. cit. supra* n. 2.
30 52 Ill. App. 2d 449, 202 N.E. 2d 49, 50 (1964).
31 *Id.*
32 *Id.* at 51.
33 *Id.*
34 *Id.*

Similarly, in the 1966 case of *Ayres Jewelry Co. v. O. & S. Building,*[35] the lease agreement stated that the leased premises were to be used as a jewelry store, and for no other purpose, without the written consent of the lessor. The rental would be a base rent plus a stated percentage of gross sales above that base rental. The tenant vacated the premises before the expiration of the lease term to open a new, larger store near the old store.

The court, noting the use clause, said that to leave the premises vacant was not to use it as a jewelry store. It emphasized the importance of the use clause in this issue:

> A paramount purpose, from a lessor's standpoint, is said to be the amount of rent to be received, and when that amount is variable and conditioned upon the use to be made of the leased premises, words relating to the use intended are of primary importance and must be construed and interpreted to have been intended as an express covenant that the occupancy specified shall be continued during the entire lease period so as to provide a constant base upon which the agreed rent formula may be applied and the rent computed.[36]

The court further said that the action of the tenant in abandoning the leased premises before the expiration of the lease served to destroy one necessary element of the rent formula. It held that this action by the tenant constituted a breach of the lease contract for which the tenant was answerable in money damages.[37]

As can be seen from the above, there is some lack of general uniformity in the area of whether or not a lessee under a percentage lease can vacate the leased premises before the expiration of the lease, and merely tender the minimum rental.[38]

Conclusions

With regard to percentage leases and the right to vacate, certain ground rules can be deduced from court decisions. If the minimum rental in a percentage lease is so low as to be nominal, or where there is no minimum rental, then a covenant to continuously operate can be implied.[39] If the minimum rental is a substantial (more than nominal)[40] guaranteed minimum, then the courts, in the past, have ruled that a covenant to continuously operate the business in the leased premises

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35 419 P. 2d 628 (Wyo. 1966).

36 *Id.* at 632.

37 *Id.*

38 Notes, *op. cit. supra* n. 2.

39 Report of Comm. on Leases, Am. Bar Assoc., *supra* n. 4; Sinclair Refining Co. v. Davis, *supra* n. 9; Lippman v. Sears Roebuck & Co., *supra* n. 11; Sinclair Refining Co. v. Gliddens, *supra* n. 15.

40 Report of Comm. on Leases, Am. Bar Assoc., *supra* n. 4.

would not be implied.[41] However, there is a trend, at present, to restrict the lessee's right to vacate the premises,[42] and, to hold that the failure of the lessee to continuously operate the business described in the use clause constitutes a breach of a percentage lease.[43]

This current trend is consistent with changes taking place today in store leases. Percentage leases have become extremely common, and, the percentage is no longer considered to be simply a "windfall" to the lessor. The modern view seems to be that the landlord is entitled to his bargain, and, his bargain is the percentage rent that would have been earned had the business been operated throughout the term of the lease.[44]

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[41] Jenkins v. Rose's 5, 10, and 25¢ Stores, Inc., *supra* n. 20; Cousins Investment Co. v. Hastings Clothing Co., *supra* n. 17; Monte Corporation v. Stephens, *supra* n. 21; Stemmler v. Moon Jewelry Co., *supra* n. 24.

[42] Notes, *supra* n. 2.

[43] Simhawk Corporation v. Egler, *supra* n. 30; Ayres Jewelry Co. v. O. & S. Building, *supra* n. 35.

[44] Landis, Problems in Drafting Percentage Leases, 36 Boston U. L. Rev. 190 (1956).