

## RETAIL & OFFICE LEASING



### Web Sales May Erode Percentage Rents

by Theani C. Louskos

The boom in E-commerce and the growth of Internet sales of retail merchandise typically purchased at the local shopping mall has complicated lease negotiations between landlords and retail tenants. The primary area of contention surrounds the tenant's obligations to pay percentage rent. Most retail leases require tenants to pay the landlord both a fixed minimum rent and a specified percentage of the tenant's gross sales from the store above an agreed-upon breakpoint. This percentage of gross sales over the breakpoint is known as percentage rent. What is included in gross sales is critical for purposes of calculating the percentage rent payable by the tenant. A key issue is how to account for a tenant's web-based sales.

The tenant places Internet kiosks in the store to give customers access to its website. When certain goods aren't in stock at the store the customer can order the merchandise from the on-site terminal.

The landlord is concerned that the diversion of sales from stores within its shopping center to a tenant's off-site website will decrease the percentage rent payable by the tenant. In response, landlords have tried to bar tenants from placing Internet kiosks within their stores. In lease negotiations, the landlord negotiates hard to include all Internet sales originating from terminals within a tenant's store in the definition of gross sales.

The tenant objects to including such Internet sales, arguing that the company website is an independent operation; the merchandise purchased is shipped from a central distribution center and not from the store where the order was placed; and payment for the merchandise is made to a separate Internet division of the company and the store is not credited with that sale. The landlord counters that without some lease restrictions, a tenant could install multiple

computer terminals in its store, maintain low inventories and encourage customers to purchase merchandise from the company website.

Some major retailers refuse to include any Internet sales in gross sales, or they will only include such sales if payment is made at the store and/or if the merchandise sold comes out of the store's inventory. The parties may agree to limit the number of on-site computer terminals that can be placed in the store. Often, this is coupled with the tenant's agreement to maintain a complete on-site inventory of merchandise.

Some landlords and tenants agree that Internet sales will only be included in gross sales if Internet sales exceed a fixed percent. Tenants also try to exclude the Internet sale of merchandise sold only from the website that is not otherwise sold at the store as part of the tenant's normal inventory.

A related problem that impacts upon gross sales and percentage rent is how to handle returns of merchandise originally sold over the Internet but returned to a particular store. Typically, the cost of returned merchandise is deducted from gross sales. However, if the original sale was not included in that store's gross sales, any deduction for returned merchandise unfairly reduces the store's gross sales and deprives the landlord of percentage rent. The typical negotiated solution is to provide that such refunds cannot reduce gross sales unless the original sale was included in the store's gross sales.

The landlord is concerned with the diversion of sales to a tenant's website and its effect on rent payable.

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