ARTICLE:
CO-TENANCY PROVISIONS IN RETAIL LEASES: LIQUIDATED DAMAGES OR ALTERNATIVE PERFORMANCE?

By Jenny Dao and Star Lightner***

Introduction

Two cases from different appellate districts in California have come to different conclusions about the enforceability of co-tenancy provisions. The Fifth District Court of Appeal in *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.*, 232 Cal. App. 4th 1332, 182 Cal. Rptr. 3d 235 (5th Dist. 2015) (*Grand Prospect*) found the co-tenancy provision in that case to be akin to a liquidated damages provision, and analyzed it under case law applicable to such provisions, ultimately finding the provision to be an unenforceable penalty. More recently, the Third District Court of Appeal in *JJD-HOV Elk Grove, LLC v. Jo-Ann Stores, LLC*, 80 Cal. App. 5th 409, 295 Cal. Rptr. 3d 725 (3d Dist. 2022) ("*JJD*") found a co-tenancy provision to be merely an agreed upon method of alternative performance of the contract, and to therefore be enforceable. This article describes co-tenancy provisions, discusses liquidated damages and alternative performance, and then reviews *Grand Prospect* and *JJD* in detail to compare the reasoning in each case.

Co-tenancy Provisions

A co-tenancy clause is a provision in a retail lease that allows tenants to reduce their rent or terminate the lease if certain key tenants leave the retail space or the total occupancy of the space falls below a certain level.[1] Typically, the tenant's remedies include some form of rent relief and/or the termination of the lease based on the happening (or lack thereof) of certain conditions.[2]

Tenants have concrete, practical reasons for needing a co-tenancy provision. First, a tenant wants to condition its presence on the presence of certain named key tenants because such key tenants are typically large and popular stores that attract patrons and increase foot traffic that spills over to other stores.[3] A key tenant is often referred to as anchor tenant and is one of the reasons that other

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smaller stores are attracted to a specific shopping center. Additionally, a tenant wants to condition its presence on a minimum occupancy level because such a condition ensures that the overall retail property remains busy and able to attract enough customer traffic to sustain the tenant's business.[4]

The tenant mix in a retail space is analogous to an "ecosystem" in which all stores share a symbiotic relationship, where many smaller tenants revolve around a few "anchor" tenants who drive traffic to the center, and the smaller tenants provide a complimentary and healthy diversity of services that complete the patrons' shopping experience.

A co-tenancy clause is usually heavily negotiated because its effects can be very consequential to the landlord during an economic downturn.[5] There is a clear risk that the inclusion of a co-tenancy clause could cause a shopping center to spiral into insolvency in the event that anchor tenant leaves or the minimum occupancy requirement is not reached. Multiple tenants could invoke the co-tenancy at once, resulting in a sudden and substantial spike in the vacancy level, and causing the center's net operating income to become negative or causing the owner to default on their debt.

Landlords disfavor co-tenancy clauses because they cannot control the action of other tenants in the shopping center. Because the co-tenancy clause is favorable to the tenant, the property owner may try to include a set of stipulations in exchange for the inclusion of such clause. Some examples include:

- Default: the language in the clause may state that the tenant cannot invoke it if they default on their lease;[6]
- Evidence: the clause may also require that a tenant provides evidence of harm or drop in sales as a result of the other vacancies. This evidence may be in the form of tax returns or operating statements that show a clear decline in sales over prior periods;[7]
- Multiple remedies: the co-tenancy clause may include limitations on the remedies available to the tenant other than reduced rent and the ability to terminate their lease.[8]

Despite the fact that co-tenancy clauses are usually heavily negotiated by the parties, there is still a risk that a harsh co-tenancy clause could be deemed unenforceable. This uncertainty stems from a recent split in the court opinions

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in *Grand Prospect* and *JJD* regarding the nature of a co-tenancy clause. Specifically, the court in *Grand Prospect* found that the parties' co-tenancy clause was a form of liquidated damages clause that needed to be reasonable under Civ. Code, § 1671, while the *JJD* court ruled that such a co-tenancy clause was simply a provision for alternative performance and was not subject to Civ. Code, § 1671 balancing.[9]

Liquidated Damages and Penalties

A liquidated damages provision in a contract provides a way for the parties to agree in advance the damages that would ensue in the event of a breach of the contract.[10] The reasonableness of a liquidated damages clause in a contract directly determines whether it is enforceable.[11] Although private parties are free to determine the amount set in their liquidated damages clause, the amount negotiated by the parties must appear to the court to be a good faith effort at estimating the actual damage that might result from a breach, to be enforceable.[12] Civ. Code, § 1671, which governs the enforceability of liquidated damages provisions, requires the balancing of the sum stipulated and the actual damages incurred by the breach.[13] Any disproportion between the stipulated sum and the actual damages must not be so large as to make it unreasonable, thereby making the liquidated damages clause unenforceable. Such disproportionate damages are considered by the courts as a penalty designed to prevent breach rather than compensation for the nonbreaching party.[14]

Liquidated damages may arise in the context of late payments. For example, *Purcell v. Schweitzer*, 224 Cal. App. 4th 969, 169 Cal. Rptr. 3d 90 (4th Dist. 2014) involved a penalty in the context of settlement agreement.[15] In that case, a creditor brought an action against a borrower on an $85,000 promissory note.[16] The parties reached a settlement agreement pursuant to which the borrower would pay $38,000 in monthly installments and that the total original liability would be due in the event of any late payment.[17] The borrower made a late payment, and the creditor brought suit for a default judgment for almost $59,000. The trial court set aside the default, explaining that the judgment was an unenforceable penalty. The appellate court affirmed, saying that the parties' liquidated damages clause was unenforceable because it failed to satisfy Civ. Code, § 1671. Specifically, the amount set forth in the parties' liquidated damages clause (i.e., $59,000) bore no reasonable relationship to the range of actual harm that the parties could have anticipated would follow from a breach (i.e., one late payment).[18] The court found the liquidated damages clause unenforce-

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able despite evidence showing that the parties agreed that the amount was reflective of their intent and economic circumstances. According to the court, public policy against unenforceable penalties may not be circumvented by words used in a contract.[19]

Another application of liquidated damages is in the event of default. In *Sybron Corp. v. Clark Hosp. Supply Corp.*, 76 Cal. App. 3d 896, 143 Cal. Rptr. 306 (2d Dist. 1978), which was decided under a former version of Civ. Code, § 1671, the parties reached a settlement on a complaint and cross-complaint under which the buyers would pay the seller $72,000 plus interest in 12 monthly installments.[20] The settlement agreement also included a liquidated damages clause that imposed a $100,000 penalty in the event of the buyer's default. After paying $42,000, the buyers became delinquent and the seller obtained a stipulated judgment of $100,000.[21] The appellate court held that the stipulated judgment was an unenforceable penalty and forfeiture because it bore "no reasonable relationship to actual damages suffered by [the seller] as the result of delay but to the contrary appears grossly disproportionate in amount."[22]

Alternative Performance

In certain situations, courts have upheld contractual penalties against claims of unenforceable forfeiture based on the doctrine of alternative performance.[23] Under this doctrine, the performing party may choose to perform one of two or more specified acts to satisfy the contractual obligation. Where the party has a contractual alternative to sustaining the penalty, the provision is not a liquidated damages clause but simply gives the party the option to perform in another way at a premium.[24]

Under this bright line rule, uncertainty regarding the distinction between liquidated damages, penalties, and alternative performance can be often avoided. If an agreement conditions one party's duty to pay a specified amount on some event or condition other than that party's breach, so that the duty arises when there is no breach, the duty to pay should not be found to be either liquidated damages or a penalty.[25] In such a case, there is no requirement that the payment be deemed "reasonable."

Prepayment fees are an example of alternative performance that has been distinguished from liquidated damages by the courts. Prepayment of a loan, for instance, is considered voluntary and does not constitute a default; thus, such prepayment constitutes "an alternative performance permitted in lieu of carry-

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ing the loan through the full term, and an agreed form of compensation for the borrower's election of the alternative early payment."[26] Accordingly, liquidated damages must be distinguished from contracts allowing one party the option of either performing or paying a sum to terminate future obligations.[27] Case law interpreting prepayment fees have found a liquidated damages analysis to be inapplicable because there was no breach of contract; rather, the contract anticipated an alternative method of performance.[28]

For example, in *Meyers v. Home Sav. & Loan Assn.*, 38 Cal. App. 3d 544, 113 Cal. Rptr. 358 (2d Dist. 1974) the prepayment penalty clauses contained in real estate loan contracts allowed borrowers an option to either pay the note in the manner contemplated by the contract or prepay the balance due upon the condition that a surcharge would be added for the privilege of exercising the option.[29] The court found that these prepayment penalty clauses did not penalize for a "breach of an obligation" as contemplated by Civ. Code, § 1671 (liquidated damages), but rather gave borrowers the option to exercise an alternative method of paying the debt. Since there was no breach of contract involved when a borrower chose to exercise his or her option to pay the debt early for a surcharge, the "prepayment penalty," despite its misnomer, was not, in fact, a penalty.[30]

Similarly, *Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan Assn.*, 22 Cal. App. 3d 303, 99 Cal. Rptr. 417 (1st Dist. 1971) was an action brought by a purchaser of realty against a savings and loan association to recover the amount of a prepayment fee paid in connection with the purchase.[31] The purchaser argued that the prepayment clause was an unenforceable penalty because the damages imposed did not bear a reasonable relationship to the injury caused.[32] However, the court noted that such principle was only invoked in cases that involve breach of a contract. Since there had been no breach by either party, the principle cited by the purchaser was irrelevant.[33] Rather, the prepayment provision was designed to provide the purchaser with an option to make prepayments, and he did not breach the parties' contract when he availed himself of the option. The court held that although the word "penalty" was used, there was no penalty in the sense of retribution for breach of an agreement, and therefore no unenforceable forfeiture.[34]

Other examples of alternative performance include:

- A fee imposed on a depository bank's customer for drawing a check on

insufficient funds, presenting a check that is later dishonored, or falling under the daily minimum balance;[35]

- A fee for early termination of an agreement;[36]
- Waiver of third payment if property were sold in an incomplete condition;[37]
- A charge of stipulated value at the time the shares of stock were received in the event of a failure to return the stock;[38]
- A percentage charge of stated sale price if property is withdrawn from sale by owner.[39]

These cases do not involve a breach of a contractual obligation. Instead, they involve provisions that provide for alternative performance, and a performing party that does not breach his or her contractual obligation when he or she exercises the option to perform alternatively at a premium.

Nevertheless, it can be difficult to distinguish between a liquidated damages clause, which is subject to section 1671 balancing and will become an unenforceable penalty if it is not reasonable under section 1671, and an alternative performance clause, which simply gives the performing party an option to complete their contractual obligations in another way at a premium.[40] There are at least two important differences between a clause liquidating damages and a clause that provides for alternative performance: (1) a liquidated damages clause is invoked when there is a breach of contract, while an alternative performance clause can be invoked in the absence of a breach; and (2) in terms of damages awarded, a liquidated damages clause does not prevent a court from awarding specific performance, but a true alternative performance provision most likely does.[41] The reason for such differential treatment is because "merely by providing for liquidated damages, the parties are not taken to have fixed a price to be paid for the privilege not to perform," while such privilege have been bargained and paid for in an alternative performance provision.[42]

The doctrine of alternative performance is applicable when the performing party has multiple contractual options, any of which would constitute compliance with the contract, but it does not apply to uphold a damages clause or other sanction for a breach of the agreement. If the penalty is tied to a clear breach, the provision will more likely be analyzed as a penalty and the issue will

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be whether it is a reasonable method for determining liquidated damages, as directed under Civ. Code, § 1671.

With that backdrop, we turn to *Grand Prospect* and *JJD.*

Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc., 232 Cal. App. 4th 1332, 182 Cal. Rptr. 3d 235 (5th Dist. 2015)

The Fifth District Court of Appeal in *Grand Prospect* held that a co-tenancy provision, which allowed the tenant to withhold rent during the cure period in the event an anchor tenant ceased operations, was an unenforceable penalty.

In this case, Grand Prospect Partners, L.P. ("Grand Prospect") owned and operated part of a shopping center in Porterville, California. The remaining portion of the shopping center was owned and operated by Mervyn's Department Store ("Mervyn's"). Grand Prospect, which was a sophisticated landlord in terms of lease negotiations, entered into a 10-year lease with an option to extend the lease every five years, with Ross Dress For Less, Inc. ("Ross") as the tenant.[43] Among the provisions that the parties negotiated was the co-tenancy provision that gave Ross the option to not open its store and withhold rent if certain anchor tenants within the center, including Mervyn's, ceased operation. If Mervyn's did not restart its operations or was not replaced by another similar anchor tenant within a 12-month cure period, Ross would be able to terminate its lease. There was evidence of correspondence between Ross and Grand Prospect with offers and counteroffers regarding the co-tenancy clause.[44]

Shortly before Ross' lease commencement date, Mervyn's went bankrupt and closed its store. As a result, Mervyn's was not in operation upon the commencement of Ross' lease. Grand Prospect and Ross entered into negotiations in an effort to make Ross open its store and pay reduced rent until there was a replacement anchor tenant.[45] However, negotiations were unsuccessful, and Ross elected to not open its store or pay rent, as permitted under the co-tenancy provision. When Grand Prospect failed to find a replacement anchor tenant within the 12-month cure period, Ross further elected to terminate its lease.

Grand Prospect brought suit challenging the co-tenancy clause on the grounds that it was unconscionable, that the termination remedy was unenforceable, and that the rent abatement remedy was an unenforceable penalty. Grand Prospect therefore sought damages in the amount of rent for the full 10-year lease. The jury found in favor of Grand Prospect and awarded the landlord

$672,100 for unpaid rent and approximately $3.1 million in other damages caused by the termination.

The appellate court affirmed in part and reversed in part. Specifically, the court disagreed with the trial court's finding that the co-tenancy provision was unconscionable, explaining such provision was freely negotiated without coercion or economic pressure by two sophisticated parties in an arm's length transaction and that the provision was not so unreasonable as to "shock the conscience."[46] The appellate court also reversed the trial court's ruling on the unenforceability of the termination remedy if Mervyn's ceased to occupy or operate its store for a period of 12 months, explaining that such right to terminate the lease was agreed upon by sophisticated parties and the conditions triggering such right had no relation to any act or default of the parties.[47] Neither Ross nor Grand Prospect had control over the operation and financial viability of the Mervyn's store. The appellate court concluded that the termination clause did not create a forfeiture, and therefore, was not an unenforceable penalty under applicable California law.

However, the appellate court upheld the trial court's finding that the rent abatement remedy of the co-tenancy provision was unenforceable due to its being an unreasonable penalty. According to the court, California courts have sometimes found contract conditions to be a penalty.[48] Here, the court found the rent abatement remedy to be a penalty because Grand Prospect had no alternative course of performance—Mervyn's owned its space in the shopping center, and Grand Prospect had no control or influence over Mervyn's decision to close its store or to lease the space to another tenant. The court then turned to the reasonableness of the penalty, seeking guidance in the rule stated in *Ridgley v. Topa Thrift & Loan Ass'n*, 17 Cal. 4th 970, 977, 73 Cal. Rptr. 2d 378, 953 P.2d 484 (1998) that "the value of the money or property forfeited or transferred to the party protected by the provision [should bear a] reasonable relationship to the range of harm anticipated to be caused to that party by the failure of the provision's requirements."[49] In its application of the rule, the court compared the value of the property forfeited by Grand Prospect and the anticipated harm or damages that Ross was likely to have experienced by the failure of the cotenancy requirement. The evidence at trial indicated that Ross did not anticipate any losses or adverse financial impact flowing from the closure of Mervyn's. Since Ross failed to prove any potential damages that would have resulted from the absence of Mervyn's in the shopping center, the court concluded that the

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there was no reasonable relationship between the value forfeited by Grand Prospect (i.e., $39,500 monthly rent) and the anticipated harm to Ross (i.e., $0).[50] It therefore found the rent abatement remedy to be an unreasonable and unenforceable penalty, and Grand Prospect was relieved of any of its obligations under such invalid liquidated damages provision, citing Civ. Code, § 1671 (balancing of damages amount and actual damages from breach) and Civ. Code, § 3275 (granting relief from unenforceable penalties or a forfeiture).

The court explained in its decision that whether a co-tenancy clause is an unreasonable and unenforceable penalty involves a fact-based analysis. It appears from the court's decision that the absence of a limitation on Ross' withholding of rent payment in the event of Mervyn's closure was largely responsible for its finding that the penalty was unreasonable.

JJD-HOV Elk Grove, LLC v. Jo-Ann Stores, LLC, 80 Cal. App. 5th 409, 295 Cal. Rptr. 3d 725 (3d Dist. 2022)

The Third District Court of Appeal in *JJD* refused to follow the logic in *Grand Prospect*, explaining that a co-tenancy clause is not a liquidated damages clause that is subject to the Civil Code section 1671 balancing analysis because such clause is not triggered by a party's default. Rather, the co-tenancy clause is a term that is heavily negotiated by the parties and therefore the risks stemming from such a provision are more appropriately dealt with by allocating its risk through the terms of the contract.

In *JJD*, Jo-Ann was the tenant who entered into a 10-year lease with JJD-HOV Elk Grove ("JJD") for approximately 35,000 square feet of space.[51] The parties' lease contained a co-tenancy provision under which JJD was required to maintain the presence of two of its three current anchor tenants or at least 60 percent or more of the gross leasable area being leased to open and operative businesses.[52] If either of the requirements was not met for the cure period of six months, Jo-Ann had the option to either continue occupancy while paying reduced rent until the vacancy was cured or to terminate the lease. Reduced substitute rent was set at 3.5 percent of Jo-Ann's gross sale or $12,000 per month, whichever was greater.[53]

In July of 2018, Jo-Ann started paying reduced substitute rent to JJD because two of the three anchor tenants at JJD's shopping center (Sports Chalet and Toys-R-Us), had closed. Jo-Ann resumed paying the fixed minimum rent when Scandinavian Designs arrived at the center as a replacement anchor tenant in

May 2020. JJD brought action for breach of contract and declaratory relief for the time period between 2018 and 2020, seeking to recover lost rent during the period of July 2018 through May 2020, arguing that the co-tenancy provision was unenforceable penalty under *Grand Prospect*. Specifically, JJD argued that the co-tenancy clause was similar to that in *Grand Prospect* because it lacked a proportional relationship between the forfeiture compelled and the damages or harm that might actually flow from the failure to perform a covenant or satisfy a condition. The appellate court affirmed the trial court's finding that the co-tenancy provision was enforceable.

In upholding the parties' co-tenancy clause, the court of appeal expressed its disagreement with the *Grand Prospect* court regarding the fundamental nature of co-tenancy clauses. Specifically, the court began with the circumstances surrounding a co-tenancy clause, noting the importance of anchor tenants in attracting more tenants to a shopping center and the lengthy back-and-forth between parties typically involved in the construction of such provisions. Here, there was evidence that the parties discussed whether the percent alternative should be 60 percent, 70 percent, or 80 percent of gross leasable area, before ultimately agreeing to 60 percent.[54] The court also cited to cases prior to *Grand Prospect* that had upheld co-tenancy clauses as enforceable.[55]

The court further explained that the *Grand Prospect* decision misapplied Civ. Code, § 1671 to co-tenancy clauses because the court did not look at the context and meaning of the statute. Section 1671, by its terms, only applies to "a provision in a contract liquidating the damages for the *breach* of the contract."[56] The *JJD* court explained that the co-tenancy clause in *Grand Prospect*, similar to the co-tenancy clause here, was not triggered by a breach of contract but by a condition precedent, i.e., the closure of certain anchor tenants or a reduction in percentage of space occupied by other tenants. According to the *JJD* court, the *Grand Prospect* court erred in finding that a condition precedent could operate as a penalty. Specifically, the *Grand Prospect* court was mistaken when it found that the co-tenancy provision "was substantially equivalent to a liquidated damages provision" and that its enforceability should be evaluated using section 1671 balancing. Rather, in *JJD*, the court held that the co-tenancy provision did not impose damages for breach of contract but instead simply provided for a different rent structure or alternative rent payments in the event certain contingencies (i.e., reduced occupancy of the shopping center) occurred. The court cited to *Constellation-F, LLC v. World Trading 23, Inc.*, 45

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Cal. App. 5th 22, 258 Cal. Rptr. 3d 341 (2d Dist. 2020) ("*Constellation-F*"), *McGuire v. More-Gas Investments, LLC*, 220 Cal. App. 4th 512, 163 Cal. Rptr. 3d 225 (3d Dist. 2013) ("*McGuire*"), and *Boca Park Marketplace Syndications Group, LLC v. Ross Dress for Less, Inc.*, 2019 WL 2563814 (D. Nev. 2019), order amended, 2020 WL 2892586 (D. Nev. 2020), (*Boca Park*), as instructive analyses of clauses for alternative performance.

In *Constellation-F*, a commercial lease for warehouse space contained a holdover rent provision that would require the tenant to pay an additional 150 percent of the monthly rent if the tenant remained after the lease expired.[57] The tenant failed to move out by the scheduled move out date, and the landlord filed suit seeking damages for past due rent at the holdover rate. The trial court ruled that the holdover rent was an unenforceable penalty under Civ. Code, § 1671.[58] The appellate court reversed, finding § 1671 applicable only to contractual provisions that attempted to set damages for breach of contract. The holdover rent provision was not invoked by a breach of contract but by the tenant's exercise of his option to remain in the premises at a premium. Thus, the holdover rent provision was analogous to a "graduated rental" provision under which one rate applied during the term of the lease (base rent) and the other applied after the lease expired (base rent increased by 150 percent). Since graduated rentals are not damages, the relevant provision was not subject to section 1671 balancing.

The *McGuire* decision is often cited in cases that require distinguishing between liquidated damages and alternative performance.[59] *McGuire* was a breach of contract action in which lot purchasers sought to force a vendor to pay money that it had promised to pay as an alternative to performing certain other tasks relating to the properties. The vendor moved for summary judgment on the grounds that plaintiffs could not prove actual damages and that the relevant provisions were unenforceable penalties because the required damages were disproportionately larger than the potential harm to lot purchasers. The trial court granted vendor's motion for summary judgment, and the plaintiffs appealed. The court of appeal reversed, noting that the provisions simply provided an option for alternative performance of an obligation and did not impose damages and were not subject to statutory limitations on liquidated damages. They were therefore valid "bargained for options for alternative performance."[60]

Finally, *Boca Park* involved a co-tenancy clause that gave the tenant the op-

tion to pay reduced rent if the occupancy of the shopping center fell below 60 percent.[61] The co-tenancy provision was triggered by another tenant's bankruptcy, and the tenant began paying reduced rent. The reduced rent resulted in a significant decrease in the rent payment from what the tenant would otherwise pay. The landlord brought suit against the tenant seeking a declaration that the co-tenancy provision imposed liquidated damages and constituted an unenforceable penalty.[62] The court disagreed for three reasons: (1) the closure of an anchor tenant did not constitute a breach of contract; (2) the parties knowingly negotiated two levels of rent depending on fulfillment of the co-tenancy clause; and (3) that dual rent provision was not a liquidated damages provision. In concluding that the co-tenancy clause was not triggered by a breach of contract, the *Boca Park* court found that section 1671, which only applies to situations involving a breach of contract, was not applicable. The court ruled that the correct rule statement was the one stated in *Boca Park*: "[T]he parties' contractual intent when reduced to writing should be controlling and enforced, particularly as applied to the commercial leasing market in arms-length negotiations and transactions."

Citing all of these cases, the *JJD-HOV* court based its decision on the principle that courts should not "alter a contract by construction or [] make a new contract for the parties"; rather, courts should merely interpret and give effect to the contract "without regard to its wisdom or folly, to the apparent unreasonableness of its terms, or to the fact that the rights of the parties are not carefully guarded . . . ."[63] Thus, the court found that "the parties considered and agreed to allocate the risk of reduced occupancy to JJD, and agreed JJD would receive substantially reduced rent if that risk occurred. JJD has received precisely the Substitute Rent it agreed to receive, and we find no basis for relieving JJD from the burden of its agreement."[64] Accordingly, the court affirmed the trial court's judgment.

Conclusion

The *Grand Prospect* and the *JJD* opinions differ on whether co-tenancy provisions should be analyzed under the rubric of breach of contract or alternative performance. The *Grand Prospect* court emphasized that analyses of the enforceability of co-tenancy clauses are heavily fact-based, and it relied on case law interpreting Civ. Code, § 1971, while the *JJD* court, to the contrary, found that a co-tenancy clause negotiated between sophisticated parties in a commercial setting is typically valid and enforceable when it provides for alternative

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performance.[65] Such a split in the court opinions has created uncertainty regarding how co-tenancy clauses should be interpreted, and may now need to be resolved by the California Supreme Court. Until the conflict is resolved, co-tenancy provisions should be drafted in such a way that they would be considered reasonable by a court following *Grand Prospect*. In particular, a contract clause that allows continued occupancy by the tenant after the co-tenancy clause is triggered should at least require the tenant to pay some negotiated substitute rent, or else to vacate the space, or the complete waiver of rent is likely to be construed as a penalty under the *Grand Prospect* analysis. The tenant also would be best advised to avoid using terms like "breach" or "nonperformance" in referencing the landlord's obligation to maintain the key or anchor tenants in occupancy, and instead draft the language in terms of "alternatives" if certain conditions are not met. While such language will not necessarily avoid treatment as an unenforceable penalty under the reasoning of the *Grand Prospect* opinion, it is more likely to survive scrutiny as an alternative performance provision if the landlord's failure to maintain the retail center tenant mix required by the co-tenancy clause is not plainly labeled a breach of contract by the landlord.

ENDNOTES:

[1]Giselle Roohparvar, Built-In Contract Remedies: Avoiding The Unenforceable Penalty, 27 Miller & Starr, Real Estate Newsalert 1 (Jan. 2017).

[2]*Id.*

[3]*Id.*

[4]*Id.*

[5]*Id.*

[6]See, e.g., *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.*, 232 Cal. App. 4th 1332, 182 Cal. Rptr. 3d 235 (5th Dist. 2015) (*Grand Prospect*).

[7]*Id.*

[8]*Id.*

[9]*Id.*; *JJD-HOV Elk Grove, LLC v. Jo-Ann Stores, LLC*, 80 Cal. App. 5th 409, 295 Cal. Rptr. 3d 725 (3d Dist. 2022) ("*JJD*").

[10]12 Miller & Starr, California Real Estate 4th, § 40:37 (citing *ABI, Inc. v. City of Los Angeles*, 153 Cal. App. 3d 669, 685, 200 Cal. Rptr. 563 (2d Dist. 1984)).

[11]*Id.*

[12]*Id.*

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[13]*Id.*

[14]*Id.*

[15]*Purcell v. Schweitzer*, 224 Cal. App. 4th 969, 169 Cal. Rptr. 3d 90 (4th Dist. 2014).

[16]*Id.* at 971.

[17]*Id.*

[18]*Id.* at 974 (quoting *Ridgley v. Topa Thrift & Loan Ass'n*, 17 Cal. 4th 970, 73 Cal. Rptr. 2d 378, 953 P.2d 484 (1998)).

[19]*Id.* at 975.

[20]*Sybron Corp. v. Clark Hosp. Supply Corp.*, 76 Cal. App. 3d 896, 143 Cal. Rptr. 306 (2d Dist. 1978).

[21]*Id.*

[22]*Id.* at 903.

[23]See, e.g., *JJD*, *supra*, 80 Cal. App. 5th 409; *Gutzi Associates v. Switzer*, 215 Cal. App. 3d 1636, 1644, 264 Cal. Rptr. 538 (6th Dist. 1989); *Meyers v. Home Sav. & Loan Assn.*, 38 Cal. App. 3d 544, 546-547, 113 Cal. Rptr. 358 (2d Dist. 1974); *Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan Assn.*, 22 Cal. App. 3d 303, 307-309, 99 Cal. Rptr. 417 (1st Dist. 1971).

[24]*JJD*, 80 Cal. App. 5th 409; *Switzer,* 215 Cal. App. 3d 1636; *Meyers,* 38 Cal. App. 3d 544; *Lazzareschi*, 22 Cal. App. 3d 303.

[25]*JJD*, 80 Cal. App. 5th 409; *Switzer,* 215 Cal. App. 3d 1636; *Meyers,* 38 Cal. App. 3d 544; *Lazzareschi*, 22 Cal. App. 3d 303.

[26]4 Miller & Starr, California Real Estate 4th, § 13:128 (citing *Ridgley v. Topa Thrift & Loan Ass'n*, 17 Cal. 4th 970, 978, 73 Cal. Rptr. 2d 378, 953 P.2d 484 (1998) (dictum, but citing the remaining cases in this footnote with apparent approval); *Gutzi Associates v. Switzer*, 215 Cal. App. 3d 1636, 1644, 264 Cal. Rptr. 538 (6th Dist. 1989); *Meyers v. Home Sav. & Loan Assn.*, 38 Cal. App. 3d 544, 546-547, 113 Cal. Rptr. 358 (2d Dist. 1974); *Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan Assn.*, 22 Cal. App. 3d 303, 307-309, 99 Cal. Rptr. 417 (1st Dist. 1971)).

[27]1 Miller & Starr, California Real Estate 4th, § 2:9 (citing *McGuire v. More-Gas Investments, LLC*, 220 Cal. App. 4th 512, 163 Cal. Rptr. 3d 225 (3d Dist. 2013)).

[28]*Gutzi Associates v. Switzer*, 215 Cal. App. 3d 1636, 1644, 264 Cal. Rptr. 538 (6th Dist. 1989); *Meyers v. Home Sav. & Loan Assn.*, 38 Cal. App. 3d 544, 546-547, 113 Cal. Rptr. 358 (2d Dist. 1974); *Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan Assn.*, 22 Cal. App. 3d 303, 307-309, 99 Cal. Rptr. 417 (1st Dist. 1971).

[29]*Meyers v. Home Sav. & Loan Assn.*, 38 Cal. App. 3d 544, 113 Cal. Rptr. 358 (2d Dist. 1974).

[30]*Id.*

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[31]*Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan Assn.*, 22 Cal. App. 3d 303, 99 Cal. Rptr. 417 (1st Dist. 1971).

[32]*Id.* at 307-08.

[33]*Id.*

[34]*Id.*

[35]See, e.g., *Perdue v. Crocker National Bank*, 38 Cal. 3d 913, 216 Cal. Rptr. 345, 702 P.2d 503 (1985).

[36]See, e.g., *Baumgartner v. Meek*, 126 Cal. App. 2d 505, 272 P.2d 552 (3d Dist. 1954); see also *Bach v. Curry*, 258 Cal. App. 2d 676, 66 Cal. Rptr. 220 (1st Dist. 1968); *JSA Depot, Inc., v. Superior Court*, 2013 WL 1695487 (Cal. App. 4th Dist. 2013), unpublished/noncitable.

[37]See, e.g., *Stevens v. Los Angeles Dock & Terminal Co.*, 20 Cal. App. 743, 130 P. 197 (2d Dist. 1912).

[38]See, e.g., *Miller v. California Trust Co.*, 15 Cal. App. 2d 612, 59 P.2d 1035 (2d Dist. 1936).

[39]See, e.g., *Blank v. Borden*, 11 Cal. 3d 963, 115 Cal. Rptr. 31, 524 P.2d 127 (1974).

[40]Civ. Code, § 1671; see also *Baumgartner, supra,* 126 Cal. App. 2d 505; *Stevens, supra,* 20 Cal. App. 743; *Miller, supra,* 15 Cal. App. 2d 612.

[41]Restatement (Second) of Contracts § 361 (1981) ("Specific performance or an injunction may be granted to enforce a duty even though there is a provision for liquidated damages for breach of that duty."); *Id.*, comment b ("If a contract contains a provision for the payment of such a price as a true alternative performance, specific performance or an injunction may only be granted on condition that the alternative performance is not forthcoming. But if the obligor chooses to pay the price, equitable relief will not be granted.").

[42]*Id.*, comment a.

[43]*Grand Prospect, supra,* 232 Cal. App. 4th at 1337 ("The parties were sophisticated and experienced in the negotiation of commercial leases for retail space, their negotiations involved several drafts of the letter of intent and subsequent lease, and Grand Prospect's decision to approach Ross first about renting the space was a free and unpressured choice.").

[44]*Id.,* 232 Cal. App. 4th at 1337-38. ("The letter of intent also contained co-tenancy provisions that required, at commencement and throughout the full term of the lease, 70 percent of the leasable floor area in the center be occupied by retail tenants, including Target and Mervyn's occupying 87,000 and 76,000 square feet, respectively. . . . After further negotiations, the final letter of intent, dated July 11, 2007, was signed by the parties. . . . The calculation of the 70 percent occupancy requirement state that it would exclude Ross 'and Target as to the Commencement Date to be further negotiated in the lease, from the numerator and denominator . . .' Target was required to occupy 126,000 square feet on the commencement date and during the term of the lease;

Mervyn's 76,000 square feet.").

[45] *Id.*

[46] *Id.*, 232 Cal. App. 4th at 1346 ("Unconscionability has generally been recognized to include an absence of meaningful choice on the part of the parties together with contract terms which are unreasonably favorable to the other party.").

[47] *Id.*, 232 Cal. App. 4th at 1358.

[48] *Id.*, 232 Cal. App. 4th at 1356-58 (citing *Fox Chicago Realty Corp. v. Zukor's Dresses*, 50 Cal. App. 2d 129, 136, 122 P.2d 705 (2d Dist. 1942)).

[49] *Id.*

[50] *Id.*, 232 Cal. App. 4th at 1362-65.

[51] *JJD, supra*, 80 Cal. App. 5th at ___, 2022 WL 2313437 at *1-2.

[52] *Id.*

[53] *Id.*

[54] *Id.* at *7.

[55] *Id.* (citing to *Aerojet-General Corp. v. Transport Indem. Co.*, 17 Cal. 4th 38, 75, 70 Cal. Rptr. 2d 118, 948 P.2d 909 (1997); *Third Story Music, Inc. v. Waits*, 41 Cal. App. 4th 798, 809, 48 Cal. Rptr. 2d 747 (2d Dist. 1995)); see also *Id.* at *5 (citing to *JMR Construction Corp. v. Environmental Assessment & Remediation Management, Inc.*, 243 Cal. App. 4th 571, 593, 198 Cal. Rptr. 3d 47 (6th Dist. 2015)).

[56] *Id.* at *7 (citing Civ. Code, § 1671(a); emphasis added).

[57] *Id.* (citing *Constellation-F, LLC v. World Trading 23, Inc.*, 45 Cal. App. 5th 22, 258 Cal. Rptr. 3d 341 (2d Dist. 2020)).

[58] *Id.*

[59] *Id.*

[60] *Id.*

[61] *Id.* at *8.

[62] *Id.*

[63] *Id.* at *7 (citing *In re Estate of Bodger*, 130 Cal. App. 2d 416, 425, 279 P.2d 61 (2d Dist. 1955)).

[64] *Id.*

[65] *Id.* at *6-8.

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