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"You Want What?"

Three Development Agreement Provisions that Are Very Important to Municipalities, but are Always Hotly Negotiated

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I. INTRODUCTION

For practitioners who regularly draft and negotiate development agreements between municipalities and commercial developers, there are a number of topics that are routinely covered in such contracts. For example, most development agreements describe the project that is to be completed by the developer and the time frame for delivery. Most development agreements detail the terms and conditions pursuant to which the municipality will provide certain public incentives to the project – tax increment financing, tax abatement or simply free real property. Well crafted development agreements also include important provisions about what occurs in the event that the developer fails to deliver the project that was promised in the development agreements. Parties on both sides of a real estate development will expect to see such provisions and though there may be some negotiation about each of the aforementioned covenants, these clauses are generally not very controversial.

This article will not attempt to provide a checklist for drafting development agreements or attempt to contemplate all of types of provisions that might be included in a development agreement. Nor will it attempt to explore provisions that are rarely controversial in a development agreement that memorializes a public/private partnership. Instead, this article will focus on three types of provisions that many municipalities would like to incorporate in their agreements in certain situations, but are often the subject of relatively heated negotiations.

This article will focus on (i) remedies for a municipality that desires to regain control of the real property after a developer default; (ii) "public participation" provisions that allow municipalities to participate in the profits of a development after a developer achieves an agreed-upon rate of return, and (iii) continuous operations covenants for retail operators and shopping center developers. All three of these provisions can be interesting and valuable from the perspective of a municipality, but many developers will argue that they are unfair and/or unreasonable in a number of respects. For this reason, negotiating and drafting provisions along these lines can take more time and energy than any other aspect of a development agreement in some cases. Accordingly, this article will attempt to explore each of these types of clauses in some detail. In each case, the article will explain what the provision is and how it operates, describe the legal implications of the provision and hopefully, provide some useful tips for practitioners who encounter or seek to introduce similar provisions in their development agreements.

II. "YOU CAN TAKE THE PROPERTY BACK?" -- REACQUIRING THE PROPERTY IN THE EVENT OF A CATASTROPHIC FAILURE

In many development agreements, one of the key incentives offered by a municipality is the assembly and conveyance of the real property for free or at a very nominal cost. In developments or redevelopments where free dirt is a part of the incentive package, the municipality contributing the property will often require a vehicle by which it can reacquire the property if the developer fails in a monumental way. This remedy is substantial enough that it should not be required if a developer delivers a completed project a few days late, but it is arguably a reasonable remedy to consider if a municipality contributes the ground and the developer (i) fails to ever commence construction, (ii) commences construction, but

subsequently fails in some way and abandons the project, and/or (iii) fails to deliver the development it promised for a period of time that is substantially beyond the contractual deadlines. A municipality should expect that developers will strenuously object to such a remedy, but in many cases it is appropriate and has been agreed to by parties in significant projects. A few of the most common methods that a municipality can build into its development agreements to regain control of the property include reversionary interests, buy-back provisions, and second mortgages.

A. Reversionary Interests

1. Introduction

In its simplest terms, a reversionary interest is a future interest in real property that is retained by the grantor at the time that such property is conveyed to a grantee.[2] There are a number of types of reversionary interests that can be crafted by a draftsman, but the two types of reversionary interests that are most likely to be included in a public/private development agreement are called the "possibility of reverter" and the "right of reentry."

A possibility of reverter is "a future interest retained by a grantor after conveying a fee simple determinable, so that the grantee's estate terminates automatically and reverts to the grantor if [a] terminating event occurs."[3] In the development agreement context, such a triggering event will usually be a developer's failure to commence construction of the project, a failure to meet critical construction milestones, or an abandonment of the project. Development agreements will usually provide that the developer shall have an adequate opportunity and period of time to cure after such a failure and written notice of the default from the municipality, but the important characteristic of a possibility of reverter is that the property at some point reverts back to the grantor automatically. A simple possibility of reverter clause is provided as an example:

> In the event that Developer fails to (a) commence construction of the Project on or before the Construction Commencement Date, and/or (b) fails to Substantially Complete the Project on or before the Construction Completion Date, beyond the applicable cure periods, and/or (c) Abandons the Project beyond the applicable cure periods, then the property will automatically revert back to the City.

By contrast, a right of reentry gives the grantor the right and option to enter the property and retake it if a certain triggering event occurs, but it is not an automatic reversion of the property upon the occurrence of that event.[4] A right of reentry will also typically provide for similar cure periods for a developer that has failed in some way, but assuming that a developer fails to cure a specified default, the municipality will then be required to take affirmative steps to exercise its right to take back the ground. In some cases, this may be the favorable alternative for a governing body if it is not certain that it will want the property back if the developer fails. It gives the municipality the opportunity to evaluate a developer failure and make decisions at

[2] BLACK'S LAW DICTIONARY 829 (8th ed. 2004).
[3] *Id.* at 1204.
[4] *Id.* at 1210.

the time of such failure about whether it desires to exercise its reversionary rights and remedies. A simple right of reentry provision may look similar to the following:

> In the event that Developer fails to (a) commence construction of the Project on or before the Construction Commencement Date, and/or (b) fails to Substantially Complete the Project on or before the Construction Completion Date, beyond the applicable cure periods, and/or (c) Abandons the Project beyond the applicable cure periods, then the City may, in its sole and absolute discretion, reenter and reacquire the property subject to the terms and conditions set forth below.

2. The rule against perpetuities

Another issue that lawyers and staff for a municipality must consider when retaining an interest in property given to a developer in a public/private partnership is the rule against perpetuities. The rule against perpetuities is a complicated technical legal concept that is dreaded by students in law schools and practitioners alike. The rule against perpetuities is generally that a future interest in real property is not valid unless it must vest, if at all, within twenty-one years after the death of some life in being at the time the property is conveyed. The rule applies only to future interests that are not vested at the time of conveyance.[5] Reversionary interests, including a properly drafted right of re-entry or possibility of reverter, should not be subject to the rule against perpetuities.[6] Under the common law, reversionary interests are vested remainders in property because, at the time of conveyance, the reversionary interest never left the grantor. "The possibility of reverter arises automatically in the grantor as a consequence of the grantor's conveying a determinable fee estate and is not subject to the rule against perpetuities because the possibility of reverter is 'vested' in the grantor from its creation."[7] So the interest is a present interest at the time of conveyance, through which the grantor, upon the happening of a certain event, may one day repossess the property.

Not all states follow the common law set forth above, and some consider a possibility of reverter to be a contingent interest.[8] In those few states in the U.S. that have departed from the common law, practitioners must be cautious in drafting reversionary interests so that they will vest within twenty one years after the death of some life in being. An example of a provision that would cause such an interest to vest within twenty-one years of a life in being, and thereby prevent the application of the rule against perpetuities to a particular agreement, is offered in the next section.

B. Buyback Provisions

A buyback provision in a development agreement is another vehicle that gives a municipality the power to re-possess land that is provided to a now failing developer who then fails. It is in many ways similar to a reversionary interest (discussed above), but it is drafted

[5] 70 C.J.S. *Perpetuities* § 21.
[6] 61 AM. JUR. 2D *Perpetuities and Restraints on Alienation* § 45 (2008).
[7] Wash. State Grange v. Brandt, 148 P.3d 1069, 1075 (Wash. Ct. App. 2006).
[8] 28 AM. JUR. 2D *Estates* § 207 (2008).

much like a typical option to purchase in a lease or other property document and the legal ramifications of its use are less clear. A buyback provision will typically say that in the event certain conditions occur, or if a developer fails in some material way, the municipality or grantor has the right to repurchase the property from the developer at an agreed-upon price. It is essentially a forced sale of the property after a developer failure.

An example of a relatively simple buyback provision is provided below as an example:

> In the event that Developer fails to (a) commence construction of the Project on or before the Construction Commencement Date, and/or (b) fails to Substantially Complete the Project on or before the Construction Completion Date, beyond the applicable cure periods (a "Fundamental Breach"), then the City may exercise its option to re-purchase the Site by delivering written notice of such intent, together with an earnest money deposit of Twenty Thousand and 00/100 Dollars ($20,000) to the Escrow Agent, within one hundred twenty (120) days of such Fundamental Breach. If the City exercises its repurchase rights as set forth herein, the price for such repurchase shall be One Million Dollars ($1,000,000)(the "Repurchase Price"). The repurchase of the Site shall be consummated through the Escrow Agent, at a time determined by the City no later than ninety (90) days after the delivery of the City's notice that it intends to exercise its repurchase rights. The Repurchase Price shall be payable in cash or other immediately available funds. Title to the Site shall be conveyed by the Developer to the City by special warranty deed, subject to all real estate taxes, installments of special assessments, easements, restrictions, covenants and conditions of record, except delinquent real property taxes or installments of special assessments. Any mortgage or liens, including potential mechanics liens or other liens outstanding on the Site, shall be discharged by the Developer at the Closing hereunder. Current real property taxes and installments of special assessments shall be prorated as of the date of Closing. The costs of closing and title shall be paid by Developer.

A more detailed buyback provision is provided at the end of this article as "Appendix A."

It is essential that the developer take into account the rule against perpetuities when including a buyback provision in the lease. This is because at common law, and in many jurisdictions "[a] repurchase option contained in a deed is subject to the rule against perpetuities."[9] A provision that may be included in a development agreement to protect against unintentional violation of the rule may look something like this:

[9] 61 AM. JUR. 2D *Perpetuities, Etc.* § 59 (2008) ("There is authority to the contrary, stating that the reservation of a right to repurchase in a deed creates a conditional fee, is a presently reserved vested right in the grantor, and is not subject to the rule against perpetuities, although its exercise is dependent on a future contingency.").

> If any provision of this Agreement or the application thereof would otherwise be unlawful, void, or voidable by reason of any applicable rule against perpetuities, then such provision or application shall continue only until twenty one (21) years after the death of the survivor of the now living descendants of George H. W. Bush.

As the cases that follow show, however, courts throughout the country come out very differently on how and whether the rule against perpetuities applies to buyback provisions. Prior to including a buyback provision in a development agreement, a prudent attorney should carefully check the governing jurisdiction to determine how it deals with buyback options in light of the rule against perpetuities, and whether or not it applies the rule to municipalities. The following cases describe a few ways in which jurisdictions have applied the rule against perpetuities to buyback provisions. However, the following analysis is not exhaustive, and there are a significant number of varying holdings on this issue.

1. Buyback provisions that create an option are subject to the rule

Welsh v. Heritage Homes of Delawarr, Inc.,[10] addressed the question of whether a provision in a particular Sale and Construction Agreement (the "Agreement") was a reversionary interest or a buyback provision.[11] Though there are clearly important differences between a typical development agreement and a sale and construction contract, it is nonetheless probably a fair assumption that this Sale and Construction Agreement is analogous enough to the covenants in a development agreement for purposes of the following analysis.

In *Welsh*, the plaintiffs (the "Welshes") signed an agreement to purchase a residential lot from Heritage Homes of Delawarr, Inc. ("Heritage Homes") and agreed that Heritage Homes would construct the house on the lot in question.[12] The Agreement did not provide any details on cost or construction of the home, and therefore, after approximately two years of unsuccessful ongoing negotiations between the parties, Heritage Homes sought to exercise a right to reacquire the property as provided by the Agreement.[13] The Agreement contained a provision which stated that "in the event Buyer is unable to commence construction for any reason not attributed to Seller, Buyer agrees to re-convey the subject lot at the same price as sold to Buyer, within 30 days of receipt of Seller's request to re-convey."[14]

The Welshes filed an action claiming that the buyback provision was unenforceable because it violated the rule against perpetuities because the Agreement did not establish a time period in which construction had to begin nor did it provide a specific period of time in which Heritage Homes had to repurchase the property.[15] In fact, the Agreement did not require Heritage Homes to repurchase the property at all.[16] Heritage Homes argued that "the Agreement

[10] Welsh v. Heritage Homes of Delawarr, Inc., No. 1901-VCN, 2008 WL 442549 (Del. Ch. Feb. 15, 2008).
[11] *Id.*
[12] *Id.* at *1.
[13] *Id.* at *3.
[14] *Id.* at *2.
[15] *Id.*
[16] *Id.*

create[d] a defeasible fee estate with a future interest in Heritage Homes and, therefore, [did] not violate the rule against perpetuities."[17] In other words, the Welshes sought to have the agreement enforced as a buyback provision providing a conditional option while Heritage Homes wanted it enforced as creating a possibility of reverter or a right of reentry.[18]

In response, the court explained the legal implications of these arguments:

> If Heritage Homes is correct and the Buyback Provision created some type of defeasible fee with a reversionary or future interest resting in Heritage Homes, then the Buyback Provision is not subject to the rule against perpetuities and would therefore be valid unless it is otherwise deemed to be an unreasonable restraint on alienation. On the other hand, if the Welshes are correct and the Buyback Provision is nothing more than an option of unlimited duration to repurchase the Property, then the rule against perpetuities would apply, and . . . the Buyback Provision would fail and be unenforceable.[19]

The court found that the Agreement did not create a possibility of reverter because a future action was required—the Welshes had to reconvey the property, as opposed to the property automatically reverting back to Heritage Homes.[20] Ultimately, the court determined that the buyback agreement was subject to the rule against perpetuities:

> The subtle, yet crucial, difference in the Buyback Provision that requires the Court to construe it as an option to repurchase, rather than as a fee simple subject to a condition subsequent, is that the Buyback Provision also requires Heritage Homes to pay *consideration* (the original purchase price) to the Welshes in order to reclaim title. It is that feature of the Buyback Provision that is fatal to Heritage Homes' argument and ultimately renders the Buyback Provision an option to repurchase the Property.[21]

The court held that the option violated the rule because, even assuming the construction agreement with the Welshes required them to build within three years, nothing in the contract specified the time period in which Heritage Homes must exercise its buyback option.[22] It therefore *could* vest more than twenty-one years after the death of some life in being at the time of the conveyance, and was therefore void and unenforceable.[23]

2. Buyback provisions that create an option are not subject to the rule when it is reasonable that they must vest within twenty-one years.

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[17] *Id.*
[18] *Id.* at *4.
[19] *Id.* at *5.
[20] *Id.*
[21] *Id.* at *7 (emphasis in original).
[22] *Id.* at *8.
[23] *Id.*

Byke Construction Co., Inc. v. Miller, an Arizona case with strikingly similar facts to *Welsh*, yields a completely different result. In *Byke*, a construction company ("Byke") sold land to buyers, (the "Millers").[24] The Millers signed an agreement giving Byke the option to repurchase the land if the Millers didn't begin construction of a house by a certain specified date.[25] The question before the court was whether or not this option violated the rule against perpetuities because the contract didn't give a time period in which the option must be exercised.[26] The Millers argued that this meant the option could be exercised at any time and therefore violated the rule.[27] Byke countered that "because no time period is specified, we must assume the parties intended a reasonable time period to apply, and that a reasonable time period is less than twenty-one years."[28]

The court agreed with Byke, holding that the option did not violate the rule against perpetuities.[29] "While we can not categorically agree that the rule has no significance in the world of commercial affairs,[30] we believe that when current rules of statutory construction exist which would validate a transaction otherwise void by the operation of the rule against perpetuities, they should be applied."[31] This, the court felt would adhere to the general rule that a contract should be interpreted such that it is upheld whenever possible.[32] It found that "with regard to option contracts, courts generally hold that a reasonable time period will be judicially implied where none is specified in the agreement."[33]

Applying these generally accepted rules of contract construction, the court held that the option holder would not legally be entitled to exercise the option contract after a life in being plus twenty-one years.[34] After such a long period of time, a court would not find enforcement of the contract reasonable.[35] Therefore, "the option does not violate the rule because it is not *possible* to exercise the option after twenty-one years."[36]

Assuming a court were to follow this approach in determining whether or not a development agreement with a buyback option was valid, a court may indeed find that the development must either fail or succeed within a life in being plus twenty-one years, and therefore, the buyback provision in the development agreement is not a violation of the rule

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[24] Byke v. Constr. Co. v. Miller, 680 P.2d 193, 194 (Ariz. Ct. App. 1984).
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.* at 194-95.
[29] *Id.* at 195.
[30] *Id.* at 195. The court referenced a California Supreme Court decision, *Wong v. DiGrazia*, 386 P.2d 817, 823 (1963), which held: "Since the rule against perpetuities was born in a society which extolled the tight ownership of inherited real property, it does not facilely operate as to commercial agreements in today's dynamic economy. The period of lives in being and 21 years, which works admirably with regard to gift transactions for family purposes, has no significance in the world of commercial affairs." (internal quotations omitted).
[31] *Id.*
[32] *Id.*
[33] *Id.* The court cited several cases supporting this proposition. *See, e.g.*, Smercheck v. Hamilton, 606 P.2d 491 (Kan. Ct. App. 1980); Flint v. MacKenzie, 500 P.2d 556, *reh'g denied* 501 P.2d 357 (Haw. 1972); Thompson v. Thompson, 460 P.2d 679 (Wash. Ct. App. 1969); Mohr Park Manor, Inc. v. Mohr, 424 P.2d 101 (Nev. 1967).
[34] *Id.*
[35] *Id.*
[36] *Id.* at 196.

against perpetuities. However, this application of the rule is not universal, and other states, like Delaware, in the *Welsh* case, demand a more rigid application of the rule.[37]

3. The rule against perpetuities does not always apply to municipalities

Some cases have held that the rule against perpetuities was never meant to apply to government property transactions. This position is only embraced by a small minority of jurisdictions in the U.S., but for lawyers who practice in the few states that have taken this stance, it should provide the drafters some comfort that their buyback provisions are valid and enforceable, at least with regard to the rule against perpetuities.

The case that most directly addresses this idea is *Tolland Enterprises v. Commissioner of Transportation.*[38] In *Tolland*, the state of Connecticut purchased a strip of land with the intention of building a highway.[39] When that plan was put on hold, the city conveyed the land to the plaintiff ("Tolland") subject to a repurchase provision which gave the state of Connecticut or the town of Bloomfield the right to repurchase the property for a specified amount if it should ever decide to develop the originally intended highway.[40] When the defendant tried to repurchase the land twenty-seven years after the conveyance, the plaintiff alleged that the repurchase provision was void because it violated the rule against perpetuities.[41] The trial court held that the rule shouldn't apply to governmental bodies "without first concluding that the policy of the rule in promoting the unrestricted alienability of the land will otherwise be seriously frustrated."[42] The question on appeal was whether the repurchase provision was enforceable.[43]

To aide in its decision, the court considered the purposes of the rule against perpetuities. "First, it strikes a fair balance between the satisfaction of the wishes of members of the present generation to tie up their property and those of future generations to do the same."[44] And second, "other things being equal, society is better off, if property is controlled by its living members than if controlled by the dead."[45] Based on the logic behind the rule, the court concluded that it shouldn't apply to governmental bodies.[46]

> While the theories supporting the application of the rule against perpetuities clearly apply to individuals, we conclude that its application to the state is unjustified. Unlike persons, the state is perpetually in existence. Thus, the effect of future interests in yet unborn or contingent remaindermen, or of control of property by

[37] One of the best examples of a rigid approach to the rule comes form the California appellate case, *Haggerty v. City of Oakland*, 326 P.2d 957 (Cal. Ct. App. 1958). This case has been cited to, as well as questioned for its rigidity. *Haggerty* probably doesn't affect municipalities in California, however, since the *Wong* case held the rule against perpetuities inapplicable to "commercial affairs." Wong v. DiGrazia, 386 P.2d 817, 823 (Cal. 1963).
[38] Tolland Enters. v. Comm'r of Transp., 647 A.2d 1045, (Conn. App. Ct. 1994).
[39] *Id.* at 1046.
[40] *Id.*
[41] *Id.* at 1047.
[42] *Id.*
[43] *Id.*
[44] *Id.* at 1048.
[45] *Id.*
[46] *Id.*

> those long dead, are not legitimate concerns where the state is involved in the transaction.[47]

The court cited cases from other jurisdictions in support of its conclusion, however, in most of those cases the court addressed the issue only in dicta.[48]

C. Second mortgages

Mortgages are typically used in the lending context when a borrower conveys title to property "as a security for the payment of a debt or the performance of a duty."[49] But mortgages can, and sometimes are, used creatively by municipalities to secure the performance of non-monetary obligations by developers.

Though the primary obligation secured by real property in a mortgage is usually the payment or repayment of money, there are usually a host of other non-monetary obligations contained in a mortgage which could trigger a default and foreclosure of the mortgage, even if the borrower is current on the loan payments. These obligations include things like maintaining the property, procuring insurance coverage, and refraining from transferring interests in the property without a mortgagee's consent, just to name a few. Accordingly, it is possible to create a legally valid mortgage that secures entirely non-monetary obligations, such as commencing or completing the construction of a development project within a specified time frame.

Some municipalities have used a mortgage in lieu of a reversionary interest or buyback right in development agreements, and in theory, these so-called "city mortgages" secure the performance of certain developer obligations with a pledge of the real property on which the project is located. If a developer then fails to perform its obligations secured by such a mortgage, a municipal mortgagee should then have the same rights to foreclose on the real property collateral, just as a commercial lender would if a borrower fails to repay a loan.

In most developments, the discussion of a municipal mortgage will always be about a subordinate instrument, a "second mortgage", because the developer will have an institutional lender that will insist on having the first mortgage on the project. "A second mortgage is an original mortgage created between a borrower and a lender where a senior or first mortgage

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[47] *Id.*

[48] *Id.* at 1048-49. See, Se. Pa. Transit Auth. v. Phila. Transit Co., 233 A.2d 15 (Pa. 1967); Warren v. Leesburg, 203 So. 2d 522, 526 (Fla. 1967) ("There is also grave doubt in our opinion as to whether or not public bodies such as incorporated municipalities are included within the ban of the rule against perpetuities. Perpetual charitable trusts are not subject to the rule. While not strictly analogous, property owned by a City is in a very real sense so owned and held for the benefit of the public. If perpetual charitable trusts are not 'within the spirit of the rule' it would seem that by the same reasoning a public body would be in the same category. However, it is a point of first impression, not only in Florida but apparently the United States, and we make no definitive decision thereon, especially as it is unnecessary for disposition of this appeal."); W. Indian Co. v. Gov't of the V.I., 844 F.2d 1007, 1017 (3d Cir. 1988) ("We doubt that the act of a sovereign like Denmark's concession to WICO can violate the rule against perpetuities but we need not resolve that issue."); and Joseph Schonthal Co. v. Sylvania, 21 N.E.2d 1008, 1012 (1938) ("Certainly no rule against perpetuities could ever be intended to apply to municipal corporations. On the contrary, they are designed and intended to be perpetual.").

[49] BLACK'S LAW DICTIONARY 1031 (8th ed. 2004).

already exists on the property."[50] A simple summary of the function of a second mortgage follows:

> A landowner who already holds land subject to a mortgage may wish to hypothecate his equity. He does this by taking out a "second mortgage." Should the mortgagor default in his obligation on the first mortgage, the first mortgagee may foreclose. If there is a deficiency upon sale, the second mortgagee loses his security in the equity because there is no equity. If the mortgagor does not default on the first mortgage, but does on the second, the second mortgagee can foreclose on the mortgagor's equity. Such a foreclosure would not affect the first mortgagee's rights.[51]

In many cases, a superior mortgagee will attempt to limit a subordinate mortgagee's rights to foreclose without the consent and permission of the superior mortgagee. Accordingly, from a practical standpoint, a second mortgage may not be as strong of a right to reacquire development property as compared with reversionary interests and buyback rights. However, it is an encumbrance on the property, and a developer cannot refinance or transfer the property without dealing with the municipality that holds such a subordinate mortgage. Additionally, a governing body may take some comfort in the notion that its interests will in many ways be closely aligned with the lender who holds the first mortgage and is also keenly interested in the success of the development.

D. Practice Tips

1. Understanding Both Sides of the Argument

Regardless of the method that a municipality may use to preserve a right to reacquire development property, in most cases developers will strenuously object to the concept that they could somehow lose the property. On this issue, the developer and the municipality will likely have very different perspectives.

The municipality's position will generally be that it has given the developer the real property as an incentive to accomplish some specific purpose that is of great benefit to the community. If the developer then fails to accomplish that purpose, then the city did not get the fundamental benefit of its bargain. Accordingly, the municipality may earnestly argue that the only meaningful remedy available to it would be to get the property back and contract with a new developer who can deliver the desired project.

Conversely, the developer will often argue that a right of the municipality to reacquire the property is the most draconian of remedies. The developer will generally view the real property delivered as an incentive as a vested right which should not be taken away in the high risk, always evolving world of real estate development. A developer will rightly argue that it is very difficult to predict how and, more importantly, when, the various moving parts of a commercial

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[50] R. POWELL AND P. ROHAN, POWELL ON REAL PROPERTY § 37.05[2] (2008).

[51] BLACK'S LAW DICTIONARY 1033 (8th ed. 2004) (quoting EDWARD H. RABIN, FUNDAMENTALS OF MODERN REAL PROPERTY LAW 1087 (1974)).

development will come together and therefore it is very unfair for a city to place such emphasis on deadlines that the developer will say are somewhat arbitrary. Developers will also probably point out that projects which require public incentives like free ground are typically subject to more challenges than those that are undertaken by developers in the marketplace without incentives. A developer may even go as far as to say that if a municipality could step in and take a property back if things are not going well, the risk profile of such a development may become too great for that developer to proceed.

There is validity to both sides of this argument. However, as with most things, there is a balance that can be struck. A municipality may need to insist on its right to get the property back upon a catastrophic failure, but it should also work hard to recognize that the remedies discussed in this section are very serious remedies with very damaging effects on the developer on the other side of the table. Because of this, a municipality should try to be flexible and accommodating in finding ways to make the reacquisition rights more palatable to the developer who is also taking risks in the project. This type of balancing will be discussed in detail in the following sections about provisions which are often negotiated by the parties when a municipality requests some form of reacquisition right in the development property.

2. Force Majeure

The developer may be concerned about the impact of delays that commonly occur, either in commencement or completion of the project. Such risks of delay will be critically important to the developer if their ability to retain the property is contingent upon their hitting specific construction milestones. With this in mind, developers should ask for a provision that allows the deadlines relative to a reacquisition right to be subject to delays resulting from force majeure. A force-majeure clause is "[a] contractual provision allocating the risk if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled."[52] In this context, a force majeure provision would provide that construction commencement or completion deadlines that could trigger a right of a city to reacquire a property should be moved back if and to the extent that the delay is a result of force majeure and not the fault of the developer.

An example of a force majeure provision from a development agreement is as follows:

> In the event either party hereto shall be delayed or hindered in or prevented from the performance of any act required under this Agreement by reason of acts of God, strikes, lockouts, failure of power or other insufficient utility service, riots, insurrection, discovery of cultural, archeological or paleontological resources or endangered species, war, terrorism or other reason of a like nature not the fault of the party delayed in performing work or doing acts required under the terms of this Agreement ("Force Majeure"), then performance of such act shall be excused for the period of the delay, and the period for the performance of any such act shall be extended for a period equivalent to the period of such delay.

[52] BLACK'S LAW DICTIONARY 674 (8th ed. 2004).

A developer may have an interest in defining force majeure more broadly than it is in the sample provision above. A developer may argue that any matter which is beyond its control whatsoever should be a force majeure event that pushes back development agreement deadlines. However, many governing bodies think that delays resulting from slow leasing, failures to obtain financing, and other similar risks are inherent development risk factors and are not entirely beyond the control of the developer. Accordingly, prudent attorneys should consider carefully how the definition of force majeure is crafted for these purposes.

Also, some attorneys feel strongly that if a force majeure event occurs, the provision should require the developer to report it in writing to the municipality shortly after the event occurs, rather than waiting until the developer has missed a deadline and may be tempted to be creative about reconstructing a series of "force majeure" events that occurred many months before.

3. Cure Periods

A developer who is uncomfortable with a city's request for rights to reacquire the development property will probably fight very hard for generous cure periods. They should argue that such a significant remedy should not be used if a developer misses a deadline by a matter of hours or a few days. Accordingly, a developer should ask for a reacquisition right to be subject to a prior written notice from the municipality and a sufficient period of time for the developer to cure. From the municipality's perspective, a notice and opportunity to cure should be a reasonable request because the governing body typically does not include such a provision in order to play "gotcha" with a developer, but rather to prevent a monumental failure. Accordingly, in an environment in which the city is hoping for the developer to succeed and deliver the project it promised, the municipality should agree to a written notice and an adequate period of time to cure. Obviously, much time and energy can be devoted to negotiating what an "adequate time period" to cure is for a particular project. In some cases, it might be as short as 30 or 60 days, in others it may be 120 days, 180 days or even a year. Ideally, the cure period should be long enough that the developer can receive a notice and have enough time to make meaningful progress toward the outcome that is subject to the deadline, while not being so long that members of the governing body and the public would scoff when they hear how long the developer has to cure the failure.

Additionally, in some projects, it may be reasonable for a developer to have "double cure periods." Simply, this means that if a default occurs, the municipality must first give the developer notice that it is in default and that it has a specified time in which to cure the default. If the developer does not cure, the default is established by the first period, but the municipality is not allowed to exercise its right to foreclose or reacquire the property until they give a second notice indicating that they intend to exercise their reacquisition right. This obviously gives the developer more time and makes the municipality jump through a second series of hoops before exercising such a serious remedy.

4. Abandonment

In development agreements which provide a municipality the right to reacquire the property if the developer abandons the property during the term of the agreement, the definition

of "abandonment" can be quite important. The developer will want to define the term "abandonment" as a complete exit from the property by the developer in a manner that makes clear that there is no hope of the developer returning to the project. In very narrow developer definitions of abandonment, the developer practically has to give the municipality written notice that it is walking away and never intends to come back under any circumstances. Obviously, a definition that is so narrow will make it very difficult for a municipality to ever exercise its rights in the event of an abandonment.

Typically, a municipality will seek a much broader definition that does not allow the project to idle for a significant period of time. In many cases a municipality will say that if a developer allows a project to lie dormant for some specified period of time, the project is deemed to be "abandoned." Some definitions will provide that a property is not deemed abandoned until some prescribed period after a written notice from the municipality.

An example of a definition of "abandonment" that has been used in conjunction with reacquisition rights is as follows:

> "Abandon" means that developer has vacated and relinquished possession of the Site at any time after the commencement of construction of the project for a period of one hundred eighty (180) days or more.

5. Financing and Subordination

Most developers will be very concerned about the impact that a reversionary interest, a buyback provision, or a municipal mortgage will have on its conventional financing. A typical institutional lender will not provide financing for the project, either as a temporary construction loan or more permanent financing, without a security interest in the real property. If the development agreement provides that a municipality has the option to reacquire the property if certain conditions are not timely satisfied, a lender may have serious concerns about loaning the developer the private funds to be invested in the project. Though this is a concern that the developer is likely to vocalize, it should be viewed as a problem for both parties because a municipality's goal is to stimulate a project that is likely to succeed, not to create a project that is impossible to finance. Therefore, the municipality will need to understand the lender's concerns and find ways to make them comfortable while continuing to fight for provisions that protect the governing body and the community from a complete failure.

A typical lender is used to seeing other interests in collateral that it does not like, and the solution that lenders usually propose is that the other interest in the collateral will be subordinate to that of the lender. A municipality may compromise with the developer on this issue and agree to subordinate its interest in the property to the lender's mortgage. If the municipality agrees to this, quite simply, the lender will have the first lien and the municipality will have a second lien which is subject and subordinate to that of the lender.

However, if a city's rights to reacquire development property are subordinate to a lender, a new series of problems presents itself for the municipality. If the lender is allowed to place a mortgage for $200,000,000 on the development property, for example, then as a practical matter

the municipality will never be able to exercise its reversionary interest, buyback right, or second mortgage because it cannot afford to pay the superior lien holder.

Some municipalities are willing to provide a clause in which the municipality agrees to be subordinate to a lender, but if the lender forecloses on a developer, the municipality and the lender agree to work together regarding the subsequent disposition of the property. If the developer fails, and the lender forecloses on the property, its interests and that of the municipality may be rather similar. The lender does not desire to operate the property for itself—it will be looking for another party to transfer to in an effort to satisfy the unpaid obligation of the developer. For some properties, the potential buyers that a lender would contact are rather similar to that of the developer. Accordingly, if a city can get a lender to agree that after foreclosure, it will transfer the property to a subsequent purchaser subject to the same terms as those in the development agreement (with some reasonable revisions for schedule, etc.), the city and the lender's interests will be virtually aligned in the remarketing of the property. A municipality may want to provide that although the lender will have control of the property for some finite period of time after foreclosure, at some point the municipality may have a right to exercise its reacquisition right, provided that it may have to take the property subject to the lender's lien. Accordingly, the next developer that a municipality negotiates with for the project may have to pay the prior developer's lender in order to get control of the ground. Provisions which are generally crafted along these lines are obviously more complicated than what is set forth in this article, but sophisticated real estate lenders have been able to get comfortable with city reversionary rights and buy back rights based on language crafted along these lines.

If a municipality has enough leverage in a particular development agreement, it may agree to subordinate its rights, but only up to a certain amount. Such an agreement will effectively serve as a cap on what the developer can borrow because the lender would be subordinate to the city's reacquisition rights if it lent the developer more than the agreed-upon amount. Another similar approach used by some municipalities is to contractually limit the amount of the first mortgage until certain development thresholds are satisfied. For example, in a retail development, a municipality might provide that the developer must have leases and letters of intent for 40% of the project before it can mortgage the real property for an amount more than $5,000,000. A provision like this might be controversial with a developer and its lender, but the idea is that after a project has a certain "critical mass" of leases and LOIs, it is likely to go forward and succeed, and therefore there is less risk that the municipality's reacquisition rights will ever be an issue. At the point that the developer meets its agreed-upon thresholds, the lender can mortgage up the property and render the city's reacquisition rights less meaningful, but at that juncture, the municipality will feel much more secure that the developer is going to complete the project.

5. Repayment for Improvements

Another issue that is likely to be raised if a reversionary interest or a buyback provision is exercised after construction is commenced by a developer is how to deal with the cost of improvements to the property. If the municipality exercises a reversionary interest or buyback right, the developer will want to know how much the municipality is willing to reimburse it for money it spent on the project prior to the exercise of such right. A developer will argue that in this scenario, it should be allowed to send the municipality an invoice for all of the costs it has

invested in the project since inception. A municipality will often start with the position that it should not reimburse the developer for any costs because the municipality is only exercising its right because the developer failed at developing the project that it promised to deliver.

From a developer's perspective, every dollar that it expended in a site that is reacquired by a city is lost and should be repaid by the city. However, from a city's perspective, distinctions need to be made about costs that add intrinsic value to the site and will benefit a subsequent developer, versus costs that do not provide any such carryover benefits. For example, a developer who has already commenced construction may have millions of dollars invested in so-called "soft costs," like architects fees, engineering, attorneys and marketing expenses, but those soft costs probably render no benefit that runs with the site to a subsequent developer. Similarly, only certain hard construction costs add inherent value to the site, regardless of the identity and plans of a subsequent developer. General site preparation costs, like demolition of any prior improvements, rough grading, compaction and general site utilities and infrastructure probably provide an important, but generic benefit to the property that will add value for the next developer. However, vertical construction, like a half-built building, is much less likely to be useful to a subsequent developer unless they happen to have the ability to bring the same tenant or a very similar tenant to their subsequent development of the site. Even though laying footings and foundations at a site may seem to add value, they may be too specialized to provide residual value for a subsequent use. Accordingly, as a municipality negotiates with a developer about what, if anything, it is willing to reimburse if the developer commences construction and then fails, it should probably evaluate the potential costs in a manner similar to that set forth above.

6. Including purchase agreement provisions in a buyback

Finally, in the specific case of a buyback provision, attorneys may want to be rather detailed about how the buyback is exercised and closed. In order to avoid ambiguity in the buyback provision, the municipality may want to include a sort of miniature purchase agreement within the development agreement, which specifies how the municipality may exercise the buyback right and all of the terms and conditions that govern the closing. This portion of the agreement would provide that if the municipality exercises its right to buyback the property, the closing must occur within a certain number of days of its decision to exercise the right and that the municipality should still receive the typical rights a third-party buyer would have, including the right to enter the property and conduct due diligence to determine whether there are environmental, title, survey or lien issues that have been created since the time that the developer took title from the city. While the municipality will have somewhat of an advantage in this process, as the previous owner of the property, it will be important to the municipality in order to determine whether the developer further encumbered or damaged the property while it was in the developer's possession. These provisions must also clearly set forth the purchase price, closing costs, tax prorations, representations and warranties (if any), type of deed, risk of loss and all of the other concerns that are typically addressed in a well drafted purchase agreement for real property.

III. "YOU WANT TO SHARE IN MY PROFITS?" -- ENSURING THAT INCENTIVES ARE TRULY NECESSARY THROUGH PUBLIC PARTICIPATION PROVISIONS

A. Introduction to Public Participation Provisions

In many jurisdictions, there is significant media and public scrutiny of development and redevelopment projects that require public incentives. Often, municipalities feel real pressure from the public to be good stewards of the tax dollars that are offered to developers to stimulate a particular project. These are valid concerns of the public and it is probably a good thing that municipalities feel pressure to think hard about where to provide public incentives.

The result is that many jurisdictions conduct a "but for" analysis to determine whether or not a development can occur without the benefit of certain public incentives. However, "any attempt to compare a projected return on investment for a project, with the return on investment necessary to induce the investment, requires the making of numerous assumptions as to costs and prices. These assumptions become more tenuous the longer the projection period. As a result, it may be difficult to be sure that the public incentive is necessary."[53] Accordingly, without the benefit of a crystal ball, even the most thorough and business savvy municipalities are always running the risk that they may be providing too much in the way of public incentives to a particular project. For these reasons, some jurisdictions have grown fond of public participation provisions.

Public participation provisions, also commonly known as profit sharing provisions, specify a maximum level of earnings for a development project that the municipality will consider reasonable for the developer. These maximum earnings are most often based on the cumulative annual return on the investment made by the developer. A profit sharing provision will provide that once the developer has achieved the maximum earnings specified, it must share a portion of the cash flow with the municipality, according to a certain agreed upon percentage. Public participation provisions are included in development agreements as an attempt to assure a governing body that the incentives provided are either (i) really necessary to make the development materialize, or (ii) repaid to some extent if such incentives are proved to be unnecessary in retrospect.

A typical public participation agreement generally includes a preamble that explains the philosophy behind the provision, and may look similar to the following:

> The purpose of affording public assistance to the Project is to accomplish the stated public purposes and not to subsidize an otherwise economically viable development project. While it has been determined by the City Council that the Project would not be undertaken but for the public assistance being provided, the parties recognize that the ongoing profitability of the Project to Developer is based upon projections that may or may not be fulfilled.

After setting out the philosophy of the municipality, the profit sharing portion of the provision should be articulated and it may read as follows:

> Therefore, in order to ensure that the public assistance being provided does not subsidize an unreasonable level of earnings for

[53] Martin E. Gold, *Economic Development Projects: A Perspective*, 19 URB. LAW. 193, 228 (1987).

> Developer, the parties agree that a reasonable level of earnings for the combined Project is an annual cash on costs rate of return upon the Private Funds invested in the Project from time to time by Developer of twenty percent (20%). The amount of Private Investment shall be reduced by the net proceeds of any sale of property in the Redevelopment Area by Developer.

Once the developer has reached the "reasonable level of earnings" as defined in the agreement, any excess will be divided with the municipality according to an agreed upon percentage. These provisions therefore allow the municipality to do more than just invest—theoretically, they make it possible for the municipality to benefit financially from the incentive provided.

These agreements can be tremendously important to municipalities offering development incentives because, at least in theory, they ensure that the public assistance granted to the venture does not subsidize an otherwise economically viable development project as explained above. This is a great concern for both municipalities and tax-payers. Critics of government incentive redevelopment programs may be heard arguing that the market is best left alone to fix itself,[54] or that municipalities discriminate by providing incentives to wealthy developers rather than to the weaker developers who are more in need of government subsidies.[55] Martin Gold explains that the development and redevelopment projects in need of government assistance would not be undertaken by any investor without government assistance because of the likelihood of an inadequate return on the investment.[56] "Government subsidies bring the return on investment up (or the risks down) to a level that is acceptable to the private sector."[57] Gold next addresses the discrimination concern with a reminder that "[a]dequate return on investment and appropriate risk is the sine qua non for all investors. . . . [so] [t]he fact that the recipient may be wealthy does not affect the likelihood that he will make an investment that has a low return or high risk."[58]

Public participation provisions, if clearly drafted and enforced may mitigate some of the criticism regarding government incentives, while simultaneously reducing the impact of an incentive that later proves to be unnecessary by eventually bringing that money back to the municipality—making it more of an investment than a subsidy. Development agreements that provide for public participation may be seen as less of a market interruption because, if successful, the market will repay the government just as it would a lender. Additionally, concern over the wealthy getting wealthier may be less because under a public participation agreement the government can, to some extent, cap the earnings of the developer through the forced repayment agreement.

From, a developers' perspective, however, the idea of sharing profits with a municipality may be objectionable. Though a municipality may argue that public incentives should only be provided to developments that would never have been possible "but for" the incentive, the developer may respond that it should not be penalized if its hard work, contacts, business

[54] *Id.* at 229
[55] *Id.* at 229-30
[56] *Id.* at 230
[57] *Id.*
[58] *Id.*

methods and efficiency create a more successful project than originally anticipated. The developer will undoubtedly feel fully entitled to its own profits. Additionally, the developer may struggle with the notion of profit sharing because it must take on significant risk in getting a development off the ground. A developer should argue that a healthy rate of return is, in no small way, an appropriate and reasonable reward for taking on the majority of the risk of a project's success or failure. It may be difficult for a developer to accept that if it should fail on a project, there may be no limit to the down side risk; however, if that same developer succeeds, the municipality, who has probably assumed less risk, may cap potential rate of return and share in the excess profits.

B. Practitioner's Tips

Given these different vantage points, several aspects of a public participation provision will be the subject of negotiations between the parties. Such provisions can be tremendously complicated and both parties' financial analysts will be valuable in the negotiations. There are countless issues that parties might negotiate about if a public participation provision is included in a development agreement, but a few of those issues are highlighted and discussed below.

1. Agreeing upon returns

What is the appropriate rate of return for a particular project? There will always be a vigorous discussion about the threshold at which a developer must begin to share its profits with a municipality. Unfortunately for municipalities, the developer will have much more working knowledge about rates of return than the municipality or its staff. The developer has probably been thinking about what kind of return it could achieve from the very first moment that it heard about the project. A municipality and its staff will have to work much harder to determine what a fair rate of return would be and at what point the municipality feels that it should share in the profits of the project. There are a number of resources available in the real estate market that report on rates of return for real estate development. One such resource is the *Price Waterhouse Coopers Korpacz Real Estate Investor Survey*. *Korpacz* gives a quarterly range of returns as well as an average return for certain types of projects, and this type of information can be useful to a municipality which is trying to decide how much money a developer should make before the municipality would feel that public incentive was not necessary in the first place.

A developer, however, would caution a municipality against focusing on the low end of a range or simply targeting an average return as the threshold number for a public participation agreement. Instead the developer would argue that the municipality should be protecting against a "windfall," but not against the average return that is typical in these types of projects. An average return does not constitute a windfall. Additionally, a developer would rightly argue that if a municipality gets a reputation for driving down returns of developers that come in to invest in its community, it might inadvertently chill development.

Accordingly, the threshold percentage is not an easy number for a municipality to settle on.

2. Matching the reward with the risk

The developer should request, and the municipality should probably concede to a provision that caps the municipality's profit sharing if and when the amount of profit sharing received by the municipality is equal to the amount of the public incentive paid by the municipality. In other words, the developer may argue that the public participation provision should not be a windfall for the municipality either. A municipality should not recoup more than it invested initially. For example, if the municipality provides the developer a $10 million incentive and then the developer's rate of return for the project exceeds the agreed-upon threshold and the public participation provision is triggered, the municipality should only be entitled to share in the developer's profits up to an amount equal to $10 million dollars.

Additionally, the developer and the municipality must agree upon the percentage of the profits to be shared once the rate of return threshold is met. In other words, in most public participation provisions, the municipality does not receive 100% of the profits after the threshold is met until the incentive is fully "repaid." Rather, the parties typically agree that the municipality receives 20%, for example, of each dollar of profits after the threshold until its share equals that of the incentive initially provided by the city. The parties may agree on any amount based on their negotiations, but one commonly held view is that the percentage the municipality receives should bear some relationship to the ratio of public incentives to private funds invested in the project. For example, if the public incentives in a particular project amount to $30 million, and the overall project costs are $100 million, the argument is that the municipality's share should logically be equal to 30%. This figure may be more difficult to pinpoint if the municipality's contribution includes free real property, but the parties may still use an appraisal or other methods to arrive at a percentage that adequately recognizes the contributions of the municipality.

3. Equity Return vs. Project Return

Because a public participation provision will be triggered by the developer's internal rate of return ("IRR") it is important to note that there are multiple ways of calculating the IRR. Perhaps the most common methods are equity IRR and project return. An equity IRR is based on the developer's return on their equity in the project. While equity can be defined a number of ways, an equity IRR is often based on the amount of cash the developer has actually contributed to the project, not including his private loans. A project IRR, on the other hand, considers all overall numbers, treating debts of the project as part of the developer's contributions. A developer will generally prefer a project IRR. This typically allows the developer to make more profits on the project before the public participation provision is triggered. A municipality, however, will seek an equity IRR. Rightly or wrongly, some municipalities feel that when a developer has its own money at stake it will be more fully invested in the project. The decision about whether the IRR will be "project based", or determined based on equity will influence the way the public participation provision is drafted.

4. Sale of pad sites and sale of the entire project

Another issue that is generally negotiated in public participation provisions is how sales of all or a portion of the project affects the public participation formula. Usually, in the development of a retail shopping center, the developer will sell the pad sites to restaurants or other smaller users at a significant profit. The developer will typically use the money from such

pad site sales to pay its lender—in other words, pad site sales are a part of the developer's equity with its lender. Similarly, a developer may argue that the money earned from the sale of the pad site should be considered part of his contribution to the overall cost of the project. The municipality that has contributed the land to a project for free will typically disagree, reminding the developer that the property was part of the public incentive, so any money the developer makes by selling the pad site should be factored out and not count on the developer's side of the ledger for purposes of the public participation formula. This argument was anticipated and addressed in the above example of a public participation agreement which included this clause: "The amount of Private Investment shall be reduced by the net proceeds of any sale of property in the Redevelopment Area by Developer."

Another event that triggers questions about the public participation provision is when the developer sells the entire project to someone else. The public participation provision should probably end at that point because the developer, with whom the initial agreement was made, has left the equation and its rate of return becomes final at that point.

5. Right to Audit

Finally, a municipality with a public participation provision in its development agreement should also demand a right to audit the books and records of the developer in order to see how the project is doing financially and whether or not the IRR threshold has been met. Without a right to audit, it may be very difficult to enforce a public participation provision as a practical matter.

A common concern held by municipalities who use public participation provisions is that developers are more savvy about rates of return than the average city staff. Accordingly, many municipalities fear that public participation provisions are a great idea in theory, but the practical reality is that most developers wind up booking costs, revenues and profits in ways that rarely produce actual payments pursuant to such provisions. A strong audit right is therefore important for municipalities who view public participation provisions as real covenants to be enforced as opposed to mere "optics" that serve political purposes, but not practical ones.

A developer will want an audit right to be as limited as possible. A developer will want to (a) limit the number of times that this can happen during the term of the agreement, (b) require that the audit occur at developer's headquarters or whatever location is most convenient for them, (c) prohibit the municipality from hiring an auditor that works on a contingent fee basis, (d) have the audit conducted in a manner that minimizes interference with the developer's business and is not overly disruptive, and (e) have the municipality agree to pay for the costs of the audit. All of this is typically negotiable, but none of these things are necessarily unreasonable requests.

IV. "YOU WANT ME (OR THEM) TO STAY OPEN?" -- REQUIRING CONTINUOUS OPERATIONS FOR RETAIL DEVELOPMENTS

A "continuous operations" or "continuous occupancy" clause is a covenant which is often found in the commercial leasing context in retail developments. Generally, a continuous operations provision provides that the tenant must operate its business on the leased premises

continuously for the full term of the lease.[59] However, continuous operations can also be a very important provision in a development agreement between a retail developer and a municipality, particularly when the municipality has (a) provided the ground for free or at a minimal cost, (b) issued bonds based on projected retail sales taxes generated from a particular store or stores, or (c) provided other public incentives predicated on the notion that a retail concept would be open and provide a benefit or an enhancement to the community. Though much of the law in this area revolves around retail leasing, the issues, challenges and remedies that arise in development agreements are analogous, if not altogether similar. Naturally, though the interests of a city or other municipality may be a bit more altruistic, they are nonetheless very closely aligned with those of landlords in the retail leasing cases discussed below.

In some cases, continuous operations provisions are direct and straightforward. In other cases, a court will infer such an agreement from implied continuous operations provisions in a lease or other agreement.

One example of an express continuous operations provision found by a court to be enforceable states that, "[t]enant covenants and agrees that, continuously and uninterruptedly from and after its initial opening for business, it will operate and conduct within the leased premises the business it is permitted to operate and conduct under the provisions of this lease."[60] Another example provides "[t]enant agrees to . . . operate one hundred percent (100%) of the Leased Premises during the entire Term . . . with due diligence and efficiency so as to produce all of the Gross Sales which may be produced by such manner of operation."[61]

Other courts have dissected lease agreements in search of circumstances and provisions that imply the parties intended continuous operation of the leased premises—these are known as implied continuous operations clauses. Implied continuous operations provisions should be avoided in favor of a clear and express provision requiring continuous operations, because "[a]s a general rule, implied covenants are not favored in the law."[62] However, it is helpful to note the factors that courts consider when implying continuous operations covenants so that, if an express covenant is found to be deficient in some way, the agreement may be drafted in such a way that otherwise supports, if not implies such an obligation. Some of the most regularly considered factors are "(1) whether base rent is below market value, (2) whether percentage payments are substantial in relation to base rent, (3) whether the term of the lease is lengthy, (4) whether the tenant may sublet, (5) whether the tenant has rights to fixtures, and (6) whether the lease contains a noncompetitive provision."[63] Where several of these factors indicate that continuous operation was intended by the parties to the lease, the court may find an implied continuous operation

[59] *See, e.g.*, William L. Patton, Jr. Family Ltd. P'ship v. Simon Prop. Group, Inc., 370 F. Supp 2d 846, 848 (E.D. Ark. 2005).

[60] W. Props. Joint Venture I v. Kinney Shoe Corp., 1992 WL 3657 at *1 (Minn. Ct. App. 1992). The language used in this clause was found valid in a Minnesota appellate court, however, courts vary significantly in what language they hold to be enforceable. It will always be in a municipality's best interest to look to the case law in its jurisdiction in order to determine what language the court has held to be enforceable.

[61] Austin Hood, *Continuous Operations Clauses and Going Dark*, 36 REAL PROP. PROB. & TR. J. 365, 373 (2001) (quoting CBL & Assoc., Inc. v. McCrory Corp., 761 F. Supp. 807, 808) (M.D. Ga. 1991) (alteration in original).

[62] William L. Patton, Jr. Family Ltd. P'ship v. Simon Prop. Group, Inc., 370 F. Supp 2d 846, 848 (E.D. Ark. 2005).

[63] *Id.* at 849 (quoting Lagrew v. Hooks-SupeRx, Inc. 905 F. Supp. 401, 405 (E.D. Ky. 1995).

agreement.[64] For our purposes, it is enough to acknowledge that implied clauses exist and that some of the cases discussed in the damages portion of this section found implied, rather than express covenants. The analysis in computing damages, however, should be largely the same, regardless of whether the agreement is express or implied.

A continuous operations agreement is important in a retail development because of the impact that a store closing, frequently referred to as "going dark", can have on the rest of the shopping center or development. "Store closings, whether temporary or permanent, could affect several aspects of the operation of a shopping center such as the 'vacancy rate, tenant mix, customer draw, profitability, or [the] ability to relet the space.'"[65] Put even more poignantly, Emanuel Halper explains:

> Shopping center landlords who discover that a tenant has stopped doing business are profoundly disappointed. A vacant store of any kind, whether rented or not, has a depressing effect upon a shopping center. Shopping center merchants depend upon each other's presence to draw customers to the shopping center. When one of them stops doing business, the draw is reduced. When an anchor tenant, such as a department store or a supermarket, stops conducting business, the aroma of death may permeate the atmosphere.[66]

A. Damages

Because the effects of "going dark" often impact the entire development, it is important to know what damages are available for the breach of a continuous operations clause. The three main types of damages available are: (1) specific performance; (2) liquidated damages; and (3) compensatory damages.

1. Specific Performance

The ideal remedy for a landlord or municipality who helplessly watches an important retailer "go dark" is specific performance. Pursuant to this remedy, the court forces the tenant to fulfill the contract by re-opening the store and continuously operating until the lease term expires. Because specific performance is an equitable rather than a legal remedy, landlords will often specify this particular remedy in a lease with language similar to the following: "Lessor shall be entitled not only to damages, but also to injunctive relief to enforce the covenants contained in this Section to compel performance of the terms hereof, and to restrain and enjoin any breach or threatened breach thereof." Landlords generally believe that inclusion of such a provision will make a court more likely to grant equitable relief than it otherwise would be. Even with such a provision, however, courts rarely grant specific performance for two primary reasons.

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[64] For a more thorough explanation of implied continuous operations clauses, see Hood, *Continuous Operations Clauses and Going Dark*, 36 REAL PROP. PROB. & TR. J. 365, 376–85 (2001).
[65] *Id.* at 366.
[66] Hornwood v. Smith's Food King No. 1, 807 P.2d 208, 210 n.4 (Nev. 1991) (quoting EMANUEL HARPER, SHOPPING CENTER AND STORE LEASES, § 9.02(b) (1989)).

First, with the already stacked and ever-increasing case load that burden our current judicial system, courts avoid granting equitable relief that will place a court in the unenviable position of constant monitoring and supervision of a local retail store. "A promise will not be specifically enforced if the character and magnitude of the performance would impose on the court burdens in enforcement or supervision that are disproportionate to the advantages to be gained from enforcement and to the harm to be suffered from its denial."[67] Courts would arguably suffer a significant burden in supervising and forcing a retail store to re-open and exist harmoniously with its landlord. A relatively small number of courts have ordered specific performance for the breach of a continuous operations agreement,[68] but the great majority of courts find the burden on the court too ominous and the remedy of monetary damage sufficient to indemnify the landlord. In *New Park Forest Associates II v. Rogers Enterprises, Inc.*[69] the court bluntly explained its concerns: "Problems may never arise. If problems did arise, however, the court would find itself in the business of managing a shopping center."[70]

Second, where "the damages are purely economic and there is therefore an adequate remedy at law,"[71] injunctive relief is unnecessary. Equitable relief, like the remedy of specific performance, should only be granted where damages cannot be quantified or would not be sufficient. In many cases, while damages to the landlord may be somewhat speculative, courts generally conclude that they can still be quantified. "The availability of money damages to compensate for some of the harm suffered by a nonbreaching party does not necessarily preclude an injunction; instead, the issuance of injunctive relief depends on whether there are additional injuries for which money cannot compensate the nonbreaching party."[72] Courts will almost always find a way to conclude that money is an adequate remedy to compensate the nonbreaching party.

In *8600 Associates Ltd. v. Wearguard Corp.,*[73] a lease agreement between a retail landlord and its tenant included an express continuous operations clause as well as an agreement giving the landlord the right to seek mandatory injunctive relief upon breach of the continuous operations agreement.[74] The court held that it is "within the court's discretion to refuse an injunction to enforce a continuous operations clause in a lease agreement where it would unreasonably tax the time, attention and resources of the court."[75] The plaintiff in *8600 Associates Ltd.* argued that no legal remedy would be adequate because it would be impossible to measure the harm it would suffer as a result of the defendant's store closing.[76] It explained that it would lose customers who would have come to the shopping center in order to go to the Wearguard's store in question, as well as customers who will stop coming to the center because

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[67] RESTATEMENT (THIRD) OF UNFAIR COMPETITION §366 (1979).
[68] *See, e.g.,* Lonoke Nursing Home, Inc. v. Wayne & Neil Bennett Family P'ship 676 S.W.2d 461 (Ark. Ct. App. 1984); Lincoln Tower Corp. v. Richter's Jewelry Co. 12 So. 2d 452 (Fla. 1943); Madison Plaza, Inc. v. Shapira Corp., 387 N.E.2d 483 (Ind. Ct. App. 1979); Dover Shopping Ctr, Inc. v. Cushman's Sons, Inc. 164 A.2d 785 (N.J. Super. 1960); Slater v. Pearle Vision Ctr, Inc., 546 A.2d 676 (Pa. Super. 1988).
[69] New Park Forest Assoc. II v. Rogers Enter., Inc., 552 N.E.2d 1215 (Ill. App. 1990).
[70] *Id.* at 1220.
[71] Mayor's Jewelers, Inc. v. State of Cal. Pub. Employees' Retirement Sys., 685 So. 2d 904, 905 (Fla. App. 1996).
[72] Metro Sports Facilities Comm'n v. Minn. Twins P'ship, 638 N.W.2d 214 (Minn. App. 2002).
[73] 8600 Assocs. Ltd. v. Wearguard Corp., 737 F. Supp. 44 (E.D. Mich. 1990).
[74] *Id.* at 45.
[75] *Id.* at 46 (citing Madison Plaza, Inc. v. Shapira Corp., 387 N.E.2d 483 (Ind. App. 1979).
[76] *Id.*

they view the development as a failure. Plaintiff also argued that other tenants may close when they perceive that the continuous operations provision is unenforceable.[77] The court nonetheless found that "plaintiff has an adequate remedy at law in that its damages are purely economic and it retains the right to relet the retail space."[78]

2. Liquidated Damages

Another potential remedy which is commonly used in retail leasing is liquidated damages. Liquidated damages are monetary damages that the parties to the agreement determine in advance to be appropriate upon a breach of the continuous operations covenant. These damages are then specifically provided for in the agreement.

Landover Mall Ltd. Partnership v. Kinney Shoe Corp.,[79] addresses the enforcement of a liquidated damages clause and provides a good example of how a court may assess the validity of the provision. In *Landover Mall*, the parties agreed that the tenant ("Kinney") must continuously operate, and that if Kinney failed to do "for one or more full business days" the landlord could increase Kinney's minimum rent and percentage rent by 100%.[80]

After operating the store for nearly twenty years, Kinney closed the store at Landover Mall, as well as approximately 300 other Kinney stores in an effort to save the failing chain.[81] In the case that followed, the court, in determining whether or not to grant summary judgment, only considered the singular issue of whether the "liquidated damages clause" was in fact such, or was really a penalty for breach.[82] If the clause was found to be a penalty, the court would not enforce it, but if it was found to in fact be a liquidated damages clause, then it was enforceable as written. Because this was a motion for summary judgment, the court noted that "[i]f there is any doubt as to whether Article Two (G) is an enforceable liquidated damage clause or a penalty, it must be construed as a penalty."[83] It explained that:

> Under Maryland law, in order to find that an agreed upon term is an enforceable liquidated damage clause, the following must be shown: '(1) [the] parties, at or before the time of execution of the contract, agree[d] upon and name[d] a sum therein to be paid as liquidated damages; and (2) [that sum was] in lieu of anticipated damages which [were] in their nature uncertain and incapable of exact ascertainment.'"[84]

While this is Maryland law, a similar analysis would likely be applied in the majority of states. The court considered the facts and found that it would have been impossible to predict the

[77] *Id.*
[78] *Id.*
[79] Landover Mall Ltd. P'ship v. Kinney Shoe Corp., 944 F. Supp. 443 (D. Md. 1996).
[80] *Id.* at 443.
[81] *Id.* at 444.
[82] *Id.* at 445.
[83] *Id.*
[84] *Id.* (quoting Baltimore Bridge Co. v. United Rys. and Elec. Co., 93 A. 420 (1915)).

amount of damages for breach of the agreement because it could affect the customer draw, profitability, and many other aspects of the mall's business.[85]

The court then considered whether doubling the minimum monthly rent was a reasonable estimate of the potential damages at the time the lease was signed. It found that at the time the parties entered into the lease, they both knew that a breach of the continuous operations agreement could have harmful effects on Landover Mall, but they couldn't know how severe those effects might be. "For example, the fact that the Kinney Shoe store was no longer inside Landover Mall may have kept Kinney's regular customers from shopping at the Mall. In turn, this may have deprived other Landover Mall stores of those customers' business, which may have decreased any percentage rent that Plaintiff may have received from those retail stores."[86] Since there is clearly no way at the inception of the lease to quantify those damages, the court found that doubling the rent was a reasonable estimation of the damages Landover Mall could potentially suffer.[87] Having fulfilled the two requirements of a valid liquidated damages provision, the court granted the plaintiff's motion for summary judgment.[88]

3. Compensatory Damages and Consequential Damages

Finally, compensatory and consequential damages are also possible remedies against a retail operator that "goes dark" before the term of the operating covenant expires. These remedies, however, may not be as accessible to municipalities that do not own the property. Nevertheless, they are worth briefly mentioning here.

Compensatory damages are calculated as "the difference between the 'present worth of the property with the lease less the present worth of the property without the lease.'"[89] In *Hornwood v. Smith's Food King No. 1*,[90] a 1991 Nevada case, the anchor tenant of a shopping center "went dark" in violation of an implied continuous operations provision.[91] The court held:

> [D]amages in this case should be assessed as the present worth of the property with the anchor tenant less the present worth of the property without the anchor tenant. Further, we define 'without the anchor tenant' in this opinion to exclude any value the shopping center may derive from Smith's current subtenants, or from any subtenants Smith's acquires for the demised premises in the future. We so define 'without the anchor tenant' because of uncertainties created by Smith's breach of contract and to insure the Hornwoods adequate compensatory damages.[92]

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[85] *Id.*
[86] *Id.* at 446.
[87] *Id.*
[88] *Id.* at 447.
[89] Hornwood v. Smith's Food King No. 1, 807 P.2d 208, 211 (Nev. 1991) (quoting Washington Trust Bank v. Circle K Corp., 546 P.2d 1249, 1252 (Wash. App. 1976).
[90] *Id.*
[91] *Id.*
[92] *Id.* at 212.

Compensatory damages, while an important remedy for property owners, are probably not available to a municipality when a tenant in its development project goes dark. Since the municipality does not own the development, the difference in value of the property is something that primarily affects the developer or current owner of the property, and only impacts the municipality in remote and intangible ways – like ad valarem tax value and the intangible impact to the community at large.

As the law is applied in *Hornwood*, compensatory damages are available for injuries stemming from the actual breach of the lease agreement, including injury to the property, but not for damages that result from the injury to the property. It is here that consequential damages come into play. Consequential damages are "[l]osses that do not flow directly and immediately from an injurious act but that result indirectly from the act."[93] Consequential damages then, reach beyond a decrease in the worth of the property to the impact that decrease in worth may have on current and potential tenants, customers, and further development of the property. These damages may be available to a municipality in certain limited circumstances in which its interests are affected. For example, suppose a municipality contracts with a developer to start a large shopping center with a few big box stores as anchor tenants. Assume that the developer completes and begins operation of one section of the development with the intention of further developing an additional fifty acres of property soon afterward. If an anchor tenant goes dark in the first section of the development and the developer is subsequently unable to develop the remaining fifty acres because of a lack of interest due to the anchor tenant's breach, both the developer and the municipality may seek consequential damages from the breaching anchor tenant. This argument would be based on the impact the anchor tenant's breach had on the undeveloped land.

B. Practitioner's Tips

1. Drafting a continuous operations clause into a development agreement

A municipality may seek continuous operations provisions in two distinct development agreement scenarios. One is when it is entering a development agreement with a retailer that will operate the project for its core business purpose (i.e., selling merchandise at retail). An example of this might be a municipality negotiating directly with a Wal Mart to develop a piece of land and operate a typical Wal Mart store on it. Another, perhaps more complicated scenario, is where the developer is not the end user. An example of this is a municipality working with a commercial developer to develop a shopping center. The developer will maintain the lease and manage the shopping center, but will not actually operate a store of any kind. Instead the developer will find retailers to fill the available space, and those retailers will be the operators.

In the first scenario, a development agreement with the operator of an anchor store, the drafting is not too challenging. The attorneys simply craft a continuous operations clause that is given by the retailer in favor of the municipality. There may be nuances about how long the provision runs, what the remedies are or excused instances where the retailer may close temporarily for remodeling or as the result of a casualty. However, the provision is a direct

[93] BLACKS LAW DICTIONARY 416 (8th ed. 2004).

obligation between the municipality, the party requesting a continuous operations covenant, and the retailer, the party required to perform thereunder.

By contrast, in the second scenario, the developer of a shopping center will not be operating a store and therefore cannot be the party to actually perform under any continuous operations provisions requested by the municipality. The municipality may however include a sort of pass-through continuous operations obligation in its agreement with the developer which may require the developer to obtain continuous operations agreements from the tenants of the shopping center in its leases with those tenants.. The municipality can argue that its interests and that of the developer are aligned in that both want the developer's tenants in the shopping center to open and stay open in order to ensure the success of the shopping center and that the expectations for the project are met.

The municipality should understand, however, that the developer will have valid reservations about such pass-through continuous operations covenants. First, experienced developers will have encountered this same dialogue before in their lease negotiations and such developers will rightly say that many big box stores refuse to sign continuous operations agreements. Because these big box tenants are essential to most developments, both the developer and the municipality will want a good continuous operations covenant, but anchor tenants like big box stores have significant leverage in these negotiations and many will in fact walk away from potential developments that would require them to continuously operate for any significant period of time. Accordingly, a contractual covenant from a developer that requires it to obtain continuous operations clauses from all of its tenants could materially harm the developer's leasing efforts and put the developer in the unenviable position of being unable to secure desirable anchor tenants for the project. This can, and often does have a trickle-down effect on other potential tenants who seek locations near key anchor tenants and rely on such anchors to draw pedestrian and vehicular traffic to the shopping center. Developers are also likely to say that including a mandatory pass-through continuous operations clause in a development agreement puts the municipality in a position of micro-managing retail leasing of a shopping center, and that the developer is in a far better position to know how to get a shopping center development off the ground. Both parties have much at stake in this dialogue, and a prudent municipality and its staff should probably allow a developer that it trusts with its public incentives enough room to operate and lease the center, without inadvertently chilling leasing activity with an overly burdensome continuous operation pass through.

In an attempt to strike a balance, a municipality may suggest a development agreement provision that requires the developer to use "commercially reasonable efforts" or perhaps even mere "reasonable efforts" to get reasonable continuous operations agreements from the ultimate tenants. This kind of provision puts the developer under contract to try to obtain such agreements, but should not penalize the developer in those circumstances that would cause the developer to lose a good tenant if they were forced to be unwavering in their attempts to get a retailer to continuously operate. "Best efforts" language may also be used, but may be too high a threshold, since the developer would have to go to extraordinary lengths to try to secure the agreements or else risk a breach of the development agreement. The developer would probably start asking good questions about whether they have to give away the space at bargain basement rents in order to obtain continuous operations from a given tenant. "Is that what 'best efforts'

means?" they may ask of a city and its staff. Accordingly, many lawyers may feel that a "commercially reasonable" threshold may be the proper standard in this context.

2. Determining the Duration of the Agreement

Many development agreements run for the life of the bonds for the public incentive, which may be as long as 20 years or even longer. A development agreement that includes a continuous operations covenant that survives for the length of the development agreement may be an unrealistic expectation because most retailers cannot predict their sales and likelihood of success over such an extended a period of time. Accordingly, most retailers will have a very difficult time covenanting to remaining open for a period of 20 years, for example. Generally, a municipality's argument in this context is that if the amortization of bonds or such other public incentives are reliant upon sales taxes the retailer is creating, the term of the continuous operations agreement should be coterminous with the life of the bonds. A city might say that this is especially true because one of the primary reasons that the retailer is receiving the incentive is because their store is projected to generate substantial sales taxes over the life of the bonds.

A municipality should be prepared for lengthy, and often heated, negotiations before it will reach an agreement with a retailer or a developer on a continuous operations provision. Perhaps the best initial position for a municipality to take is that the continuous operations agreement should be tied to the life of the incentives, [94] but from there, a municipality should be prepared to scale back its expectations based on what is reasonable in the marketplace at that time and what the retailer or developer is willing to commit, given the other terms of the development agreement and the incentives on the table in that particular transaction.

Another compromise position that is offered by some municipalities is a distinction between the term of the continuous operations covenant and the remedies for a violation of such covenant. In other words, a municipality may insist on a covenant to operate that runs for the entire term of the development agreement, while agreeing to scale back the remedies available for breach after certain periods of time or other milestones. For example, the developer may only want to agree to continuously operate for eight years while the municipality may want a twenty year commitment. In this case, the municipality may require the full twenty year covenant, but agree that after eight years, its available remedies for a continuous operations breach may no longer include liquidated damages, for example. This may represent a fair compromise in some circumstances. The municipality gets a full term continuous operations agreement that will at least make the developer stop and think before it goes dark, and the developer rests assured that after some operating window that it can reasonably project, it will only be subject to certain remedies if it is forced to close.

3. Preparing for a Breach

[94] Though this assumes that the bonds or other public incentives will amortize over a relatively long time period (like 20 years), in some cases, the bonds may be projected to amortize in a very short time frame and a city may request a continuous operation provision that survives beyond the life of the bonds. Such a position is usually based on a municipality saying that it is not in the transaction for money alone, but rather the benefit to the community provided by the project. In some cases, a city may say that the bonds may pay off in 8 years, for example, but if the store closes in year 9, it may be a significant disappointment to the community, and therefore the governing body.

a. Drafting Liquidated Damages Provisions

As discussed above, liquidated damage provisions provide that the parties agree in advance upon a sum of money which is to be paid by the developer to the municipality in the event of a breach of the continuous operations covenant. Because liquidated damages are only appropriate when the nature of the default is such that actual damages will be difficult, if not impossible to ascertain, the well drafted liquidated damage clause should include language that says that the parties agree that actual damages are impractical if not impossible in this particular default scenario. This remedy may be the best option that a municipality's has available to it when requiring continuous operations of a developer. A sample liquidated damage provision may say something like the following:

> If Developer fails to continuously operate as set forth in Section 19.A of this Development Agreement, Developer shall pay to the City, as liquidated damages and not as a penalty, the sum of $_____ per day for each calendar day that such failure to continuously operate continues. The parties hereby agree that the nature of a default in which Developer fails to continuously operate the Project are impossible to ascertain and the parties have therefore agreed upon the specified liquidated damage amount as a reasonable amount. Developer hereby understands and agrees that the liquidated damages set forth above are not a penalty for Developer's failure to continuously operate as herein specified.

In the sample provision above, the amount of liquidated damages is left blank. The amount of liquidated damages will probably be a topic for dynamic negotiations between a municipality and a developer. Obviously, a municipality will want this amount to be significant so that the developer has an incentive not to close and the community receives some substantial remuneration if this occurs. On the other hand, the developer is likely to say that if business is bad enough that they are forced to go dark, any amounts that it would have to pay the municipality are just adding "insult to injury." From a city's perspective, one measure of liquidated damages that might be an interesting measure is an amount equal to the sales and/or property taxes that are projected from a fully operational and open store or project. A municipality might fairly say that, at minimum, bonds are being issued based on projections of what this particular store will generate in terms of tax revenues over the term of the agreement and if the store closes, the liquidated damages should be no less than the projections that will not become a reality because of the closed store. This is by no means the only measure that should be considered, and in most cases, the impact of a closed anchor store extends beyond just the taxes from that closed store. However, it is one interesting factor to look at as a municipality begins its analysis of what a liquidated damage amount should look like.

b. Redirection of Property Taxes and Sales Taxes

In cases where a developer buys his own bonds, issues "developer notes" and/or operates in a "pay as you go" public incentive environment, the parties may want to include a remedy in the development agreement that provides for the redirection of sales taxes and property taxes if the developer is in default of its continuous operations covenant. There is a good argument in this set of circumstances that if the developer breaches its continuous operations obligation, the developer should not longer receive the benefit of any increased property taxes (or sales taxes if there are any).[95] Even if sales taxes will no longer be produced from a particular location if a store has closed its doors, the real property taxes will probably still be greater than they were at the beginning of the development project. The property taxes may not decrease immediately. The municipality may want to include a remedy that redirects any such taxes to itself or into some other part of the development, but the municipality should fairly argue that the developer should no longer benefit from any such incremental revenues because of the fundamental breach of the agreement.

c. Buyback provisions and Reversionary Interests as Remedies for a Breach of Continuous Operations

A buyback provision or reversionary interests (discussed in detail in Section II above) may be an appropriate remedy in the event of a breach of a continuous operations covenant in a development agreement. For reasons set forth above, a municipality would say that it has not received the benefit of its bargain if an anchor tenant goes dark – particularly if the anchor was given the ground for free or at a greatly reduced costs. However, many such anchors are good credit organizations that can afford to leave a store vacant if it wants to avoid competition or if it is unsure of its future business interest in the property. The developer will generally view its rights in a store that has been completed and opened for any period of time as fully "vested." Most developers will vigorously argue that if they invested their share of money in a location that did not work for them, they, the developer should get to recoup some of their costs by disposing of the property in a way that they see fit. This could be a nightmare for a municipality that is relying on an anchor to make a project successful in a variety of ways. These issues are more acute for the municipality earlier in the term of the development agreement and generally become less painful over the life of the agreement. In other words, losing control of a dark anchor store could be less painful in the seventeenth year of a project than in the third year.

A buyback right, as opposed to a reversionary interest, may be highly beneficial in solving this problem. Even if a municipality must agree to pay as much as fair market value for the real estate and improvements that have been closed by the developer, such a right may become useful to a municipality that is proactively trying to solve the problem of a closed anchor. The municipality can actively look for a replacement anchor tenant and work out a deal where the municipality will exercise its buyback right and the new tenant will then pay for or share in the cost of reacquiring the property from the failed developer. The municipality may have the right to reacquire the property in any even through its condemnation authority, but in

[95] Though it seems obvious that if a retail store closes, that location will no longer generate any sales taxes. However, there are more dynamic scenarios where the developer may still be receiving sales tax revenues from a subtenant, or from other stores or portions of a store that remain open after one store closes.

most states, condemnation has become more complicated and more expensive in recent years a a result of *Kelo v. City of New London*.[96]

V. CONCLUSION

Given the discussion above, it is not difficult to understand why reacquisition rights, public participation provisions and continuous operations clauses can be controversial with real estate developers who are negotiating development agreements. However, in certain circumstances, these clauses can be tools that municipalities use to protect their interests in a development agreement. It is important that there is not a "one size fits all" development agreement and these types of provisions are certainly not appropriate in all public/private projects. However, there will be occasions where some municipalities will find that covenants like those discussed herein go to the heart of the interests that they are trying to protect for their community.

Practitioners who understand the legal implications of such provisions and the arguments on both sides of the table will be able to better understand where these provisions are appropriate and where they are not. Practitioners who are knowledgeable about such clauses will also have the ability to be more effective and successful at negotiating the terms of any such provisions.

[96] Kelo v. City of New London, 125 S. Ct. 2655 (2005).

APPENDIX A

A MORE COMPLICATED BUYBACK PROVISION

(1) Developer hereby agrees to construct the building and improvements (the "Improvements") on the Property in substantial conformity with plans and specifications (the "Developer's Plans") approved in Section 5 hereof by the City.

(2) In the event that Developer has not commenced construction of the Improvements on the Property on or before one (1) year from the date of Closing, as defined in Section 4 hereof (the "Construction Commencement Deadline"), then the City shall have the right, in the City's sole discretion, to repurchase the Property from Developer upon written notice from the City to Developer (the "Failure to Commence Repurchase Notice"), which Failure to Commence Repurchase Notice must be served from any time after the Construction Commencement Deadline until ninety (90) days thereafter. If the City shall exercise its right to repurchase the Property pursuant to the terms of this Section 10.A(2), Developer hereby agrees with the City that (i) said repurchase shall close within sixty (60) days of the Failure to Commence Repurchase Notice, (ii) the purchase price for the repurchase shall be One Million Dollars ($1,000,000), and (iii) Developer shall convey the Property back to the City by Special Warranty Deed, subject only to the Permitted Title Exceptions. For purposes of this Agreement, the "Construction Commencement" shall be defined as the receipt of a building permit from the Department of Codes Administration of the City, and any action to begin the construction of the Improvements on the Property that may include, but not be limited to, grading, digging or otherwise excavating the Property.

(3) In the event that Developer has not obtained from the Project Architect certification that the construction has been substantially completed and is occupied by Developer for its business operations on or before two (2) years from the Closing (the "Construction Completion Deadline"), then such failure shall be deemed a "Construction Completion Default" hereunder, and the City shall have the rights and remedies set forth in this Section 10.A(3). Notwithstanding the foregoing, the City and Developer hereby agree that:

(a) A Construction Completion Default shall not be deemed to have occurred if Developer has commenced construction by the Construction Commencement Deadline, has diligently pursued and thereafter continues to diligently pursue the same to completion.

(b) The Construction Completion Deadline shall, in addition to the above, be extended on a day-for-day basis in the event that Developer's failure to meet the Construction Completion Deadline is directly caused by fire or other casualty, national emergency, condemnation, enemy action, civil commotion, strikes, lockouts, national defense pre-emptions, or acts of God, or any other similar cause which is entirely beyond Developer's control. In the event that such delay is caused by a fire or other casualty which damages the unfinished Improvements, the City and Developer agree that the aforementioned day-for-day extension shall be based upon the time period required to

return the unfinished Improvements to the condition such Improvements were in immediately prior to the fire or other casualty.

(c) Upon any Construction Completion Default, the City shall give written notice of such Construction Completion Default (the "Default Notice") to Developer. Developer shall have a period of twenty (20) days from the date of the Default Notice to either (i) cure the Construction Completion Default, or (ii) submit to The City a written offer (the "Offer") to sell the Property back to the City, along with any unfinished Improvements thereon, which Offer shall contain the proposed purchase price and all other relevant terms and conditions. In the event that Developer fails to either cure or timely submit the Offer as set forth above, the City shall have the rights set forth in subsection (d) below. Provided that Developer has timely submitted the Offer to the City as set forth above, the City shall have a period of twenty (20) days after receipt of the Offer to accept or reject the same in the City's sole discretion. If the City shall accept the Offer pursuant to the terms of this Section 10.A(3)(c), Developer hereby agrees with the City that (w) said repurchase shall close within sixty (60) days of the acceptance of the Offer, (x) the purchase price for the repurchase shall be an amount equal to that specified in the Offer, (y) Developer shall convey the Property back to the City by Special Warranty Deed, subject only to the Permitted Title Exceptions, and (z) at closing of the repurchase, Developer shall deliver to the City full lien waivers from all contractors and subcontractors in connection with the construction of the Improvements. If the City shall reject or fail to timely accept the Offer, the City and Developer shall have the rights set forth in subsection (d) below.

(d) If, after a Construction Completion Default, Developer either (i) fails to cure the Construction Completion Default or timely submit the Offer as set forth in subsection (c) above, or (ii) Developer fails to either cure the Construction Completion Default and the City rejects or fails to timely accept the Offer pursuant to the terms and conditions of subsection (c) above, then the City shall have the right, in the City's sole discretion, to repurchase the Property from Developer upon written notice from the City to Developer (the "Failure to Complete Repurchase Notice"), which Failure to Complete Repurchase Notice must be served within one hundred twenty (120) days of the Default Notice. If the City shall exercise its right to repurchase the Property pursuant to the terms of this Section 10.A(3)(d), Developer hereby agrees with the City that (w) said repurchase shall close within ninety (90) days of the Failure to Complete Repurchase Notice, (x) the purchase price for the repurchase shall be an amount equal to "Fair Market Value" (as defined below), (y) Developer shall convey the Property back to The City by Special Warranty Deed, subject only to the Permitted Title Exceptions, and (z) at closing of the repurchase, Developer shall deliver to The City full lien waivers from all contractors and subcontractors in connection with the construction of the Improvements. For purposes hereof, the "Fair Market Value" shall be determined in accordance with the following procedure: First, the City and Developer shall each choose a "Qualified Appraiser", which Qualified Appraisers shall be selected within twenty (20) days of the Failure to Complete Repurchase Notice. Second, the two aforementioned Qualified Appraisers shall meet and jointly select a third Qualified Appraiser within ten (10) days after such Failure to Complete Repurchase Notice. Thereafter, each of the three Qualified Appraisers shall submit their respective determination of the fair market value of the

Property, assuming a market-driven transaction which is not a forced sale, and including the unfinished Improvements, to the other Qualified Appraisers and the City and Developer (together with the information forming the basis for such determination) within sixty (60) days after the Failure to Complete Repurchase Notice (with each party paying the fee for its own Qualified Appraiser and one half of the fee for the third Qualified Appraiser). The Fair Market Value shall be the average of the three appraisals; provided however, that if either or both of the high and low appraisals shall vary more than five percent (5%) from the median appraisal, either or both such appraisals shall not be considered in calculating such average. The term "Qualified Appraiser" shall mean an appraiser who is independent, with a "general" state license for appraising commercial property, a designation of MAI and a member of the American Institute of Real Estate Appraisers (or its successor), with at least ten (10) years experience appraising commercial properties in the Kansas City metropolitan area.