Contracts Problem 9

Stylish Customers (SC) is a department store downtown. SC rents its space from Bangor Savings Bank, which owns the five-story building. SC occupies floors 1-4 with clothes and home goods, and the four floors are connected by escalators. The fifth floor, not connected by escalator, is office space, with SC's back office staff (marketing, accounting, HR) in cubicles.

SC and Bangor Savings make a new lease. The new lease requires SC to pay $11,000 per month, plus 1.5% of their total retail revenue over $50,000 per month for floors 1-4. For the fifth floor, the rate is a flat $2,000 per month. The lease is a ten-year lease and permits SC to renovate as they see fit.

Once the lease is established, SC remains open as-is for a year, in which time their revenue is on average $150,000 per month. After a year, the management committee of SC meets and decides to expand into smart appliances for the home. They subsequently renovate to move the back office staff to another property and put the appliances on the fifth floor. They also build an escalator to carry customers between the fourth and fifth floors. During the subsequent year, SC doubles its monthly revenue to $300,000, largely due to the soaring success of the smart appliances section. They continue to pay percentage rentals on floors 1-4 only, and a flat rental on the fifth floor.

Please evaluate Bangor Savings's claim for additional rents. Do not use more than 250 words. If you see any parol evidence issues, please do not address them.

Contracts Problem 9 Model Answer

Bangor Savings will claim that SC has violated the implied covenant of good faith and fair dealing by installing its most profitable retail operation in the one place in the building not subject to a percentage lease deal. Assuming based on the problem that the smart appliances are bringing in an additional $150,000 or so each month in revenue, that means around $2,250 per month that Bangor Savings is not receiving in rent.

It seems that the freedom to renovate and the long lease term mean that the parties anticipated substantial freedom on the part of SC. And it is not unreasonable to house electronics on a separate floor from, say, clothing and home goods, given that they may require specialized security or climate control. Furthermore, Bangor Savings offered its lease without specifying what kinds of operations would be permissible on the fifth floor. Bangor will of course argue that the reason the fifth floor was not included in the percentage lease deal is that they had no notion of it being retail space, and when it was turned into retail space it was used for only the highest-margin goods. The test of good faith requires a weighing of the interest in running a business as the proprietor sees fit (Fortune) with the rights of the bank to receive the fruits of the contract. Assuming that adding smart appliances is good overall for SC's bottom line, which in turn makes them a more stable and perhaps long-term profitable tenant for Bangor Savings. This may be a difficult case for Bangor Savings to make insofar as it does not seem to be causing them any actual losses and seems to have been relatively easy to foresee and forestall at the time of drafting.