

*Creative Solutions is a bi-monthly column offering creative solutions to unusual problems in drafting leases for retail space. Please email your questions or problems you are encountering and your Creative Solutions to Glen Cornblath, gcornblath@ksc-law.com.*

For leases with percentage rent, the typical gross sales definition includes within gross sales the amount of all sales “when made.” In the majority of cases, that definition works well. The customer’s decision to “take it”, the payment of money and the delivery of the goods or services all occur at the same time. While some tenants have lay-away policies, they are the exception not the rule.

Then there are tenants whose business operates on the assumption that there is a large time difference between the placement of the order, on the one hand, and the payment of money and delivery of goods/services, on the other hand. Caterers (including restaurants with banquet facilities), florists, specialty apparel shops, and stationary stores have significant parts of their business in which a customer places an order weeks, months or years in advance of the event with a deposit, then pays in full in advance of delivery of the goods/services, when the goods/services are delivered or after delivery.

The typical gross sales provision will require the retailer to include the sale in gross sales “when made,” which is when the order is placed. Not only is the retailer then burdened with paying percentage rent on sale proceeds the retailer has not received, but since the contracts for the goods/services frequently allow for cancellation, the retailer may never receive any money.

However, an exception for these types of sales is too broad if it simply states the sale is included in gross sales when the tenant receives payment because the risk of collection is then the landlords. Similarly, including the sale in gross sales when the tenant delivers the goods/services results in the landlord not receiving its percentage rent in those cases where the customer makes a deposit and/or pays the money in advance of the delivery of the goods/services.

A better alternative takes a two fold approach. First, to the extent the deposit is non-refundable, it is included in gross sales when the contract is entered into with the customer. (The collection risk for the deposit is on the tenant.) If the deposit is refundable, or partially refundable, the refundable portion is included in gross sales when it becomes non-refundable, usually prior to delivery of the goods/services. For example, if the customer cancels the event, then the tenant includes in gross sales the portion of the deposit which is now non-refundable.

Second, the balance of the contract is due on the earlier of the day the payment is made, for those tenants who collect full payment prior to delivery of the goods/services, and the day the tenant delivers the goods/services. For tenants whose business requires partial payments during the “waiting period,” the partial payments should be treated as deposits: if they are non-refundable, they are included upon receipt in gross sales, if refundable, they are included when they become non-refundable.

These suggestions put the risk of collection on the tenant. If the customer puts down the deposit, takes delivery of the goods/services and then does not pay, the tenant must still include the sales amount in gross sales on the day the tenant delivers the goods/services. Landlord and tenant may alter the risk of collection by allowing the tenant to deduct from gross sales some or all of uncollected accounts receivable.

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