

AGENDA # _____

CITY OF MADISON, WISCONSIN

REPORT OF:	CITY ATTORNEY	PRESENTED	<u>May 2, 2006</u>
TITLE:	Negative Use Restrictions	REFERRED	_____
AUTHOR:	Michael P. May City Attorney	REREFERRED	_____
DATED:	April 25, 2006	REPORTED BACK	_____
		ADOPTED	_____ POF _____
		RULES SUSPENDED	_____
		ID NUMBER	_____

TO THE MAYOR AND COMMON COUNCIL:

RE: ID 03088 - Substitute Ordinance creating Section 28.13 of the Madison General Ordinances to prohibit negative use restrictions relating to grocery stores and drug stores as against public policy.

GENESIS OF THE ORDINANCE

This ordinance was drafted at the request of Ald. Van Rooy, following the closing of the Kohl's Grocery Store on the north side of Madison. The Kohl's stores were purchased by Copps. Copps had an existing store on Aberg Avenue, and initially intended to enforce a negative use restriction to keep any new grocery store from locating in the Sherman Plaza. Eventually, a new grocery store has located there.

LEGAL EFFECT OF THE ORDINANCE

The ordinance outlaws certain negative use restrictions. The ordinance finds as being against public policy and invalid such a negative use restriction if it restricts a new grocery or drug store from locating in a shopping mall or location where a prior grocery store or drug store had been located, but has closed. This was the situation at the Sherman Plaza.

Negative use restrictions are one form of restrictive covenants or covenants not to compete. The ordinance does not affect, and in fact recognizes as a reasonable business practice, a covenant not to compete that protects a grocery store or drug store from direct competition at a location in which it is in operation.

These types of covenants are most common in employment agreements, and Wisconsin courts have recognized their validity if they are reasonably limited. See Sec. 103.465, Wis. Stats.; *Lakeside Oil Company v. Slutsky*, 8 Wis. 2d 157, 98 NW 2d 415 (1959).

In at least one state, the Supreme Court has declared that covenants that extend beyond the term of the lease are not enforceable if the lessee terminates its business operations at the site. *Tippecanoe Associates II, LLC v. Kimco LaFayette 671, Inc.*, 829 NE 2d 512 (Indiana, 2005). The *Tippecanoe* case involved a dispute over just such a negative use restriction by a grocery store. The Indiana Supreme Court found that, when the prior grocer discontinued operations under its lease, it effectively severed the rationale for the negative use restriction from the lease, and the negative use restriction was no longer enforceable.

We are also aware that the City of Chicago has an ordinance similar to the one before you. The Ordinance was adopted following a controversy in Chicago similar to that involving the Sherman Plaza store.

PRACTICAL IMPACT OF THE ORDINANCE

I was unable to find significant information on how common such negative use restrictions are in the grocery business. Neither Mark Olinger nor Don Marx had any information on whether these covenants are common.

I spoke with Mr. Brandon Scholz, President of the Wisconsin Grocers Association. Mr. Scholz was unable to tell me whether such negative use restrictions are common. He did state that the grocers opposed eliminating such negative use restrictions because the inability to enforce such restrictions would have an impact on their business judgment if they were purchasing a chain of stores.

I did find one article from a weekly newspaper in Edmonton, discussing a dispute there with respect to negative use restrictions being used by Safeway stores. That article included the following:

According to Randy Ferguson, Senior Vice President of Westcorp Properties, the restrictive covenant Safeway holds so dear is nearly extinct -- and good riddance. "When I started in the mid-70's it was very, very common. Now I can't think of a new deal in the last 10 to 15 years where the restrictive covenant would outlast the lease," he told me. "If I were doing a grocery store deal today, I would not allow that kind of restrictive covenant, and I don't think there's anybody out there who would."

I have no way of verifying the statements made by Mr. Ferguson and quoted in this article. See seemagazine.com, (August 5, 2004).

CONCLUSION

Our research has not been able to determine the frequency of these negative use restrictions, although there is some indication that they may be more common in older leases. There is a developing body of law finding such covenants to be unenforceable.

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City Attorney

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