12/31/2001 CLERK OF THE COURT
FORM V000A

HON. EDWARD O. BURKE M. MINKOW
Deputy

CV 2000-006856

FILED: ___________________

S-H AHWATUKEE LLC, et al. RANDALL S PAPETTI

v.

WILD OATS MARKETS INC DENNIS I WILENCHIK

MINUTE ENTRY

The Court, having heard the evidence produced by the parties, the argument of counsel and having reviewed the exhibits and the memoranda of law submitted, makes the following:

Findings of Fact

A. Basic Facts

1. On November 2, 1994, Samuelson/Hornaday, as landlord, entered into a build and lease agreement (the "Lease", ex.1) with Reay's Ranch Markets, Inc. to be the largest tenant in Ahwatukee Square, a shopping center at 4730 E. Warner Road in Phoenix, Arizona (the "Center").

2. Plaintiffs, SH-Ahwatukee L.L.C. and YP-Ahwatukee L.L.C., are the successors in interest to Samuelson/Hornaday's rights as landlord under the Lease.

3. The Lease restricted the use of the Premises to a specialty grocery store and contains the following operating covenant:

> "From and after the Commencement Date, Lessee shall operate and conduct its business in the Premises during all Shopping Center Business Hours, as defined below, and in accordance with the provisions of this Lease. Lessee shall at all times keep and maintain in the Premises an adequate stock of merchandise and trade fixtures to satisfy the usual and ordinary requirements of its customers. Lessee, commencing with its initial opening for business in the Premises and during the entire Term, shall be open for business during at least the following hours, from 8:00 a.m. to 9:00 p.m. on all days that the Shopping Center is open for business to the public (the "Shopping Center Business Hours"). Lessor shall continuously illuminate its window displays, exterior signs and exterior advertising displays during Shopping Center Business Hours. Lessee shall not be required to remain open on recognized national holidays."

4. The Lease with Reay's Market was for a 15-year term to 2011. The rent was to be $7.50 per square foot for years 1 through 3 and $8.50 per square foot thereafter.

5. Reay’s Ranch Market occupied 26,161 square feet of space in the Center, which was more than half of the leasable square feet in the Center. The Landlord considered Reay’s Ranch Markets to be an anchor tenant.

6. The Center would not have been built without the Reay's Ranch Markets lease.

7. While Reay's Ranch Markets was open in the Center, the "side shops" stayed full, i.e., the two vacancies that occurred were re-leased within a month.

8. Defendant Wild Oats Markets, Inc. (Wild Oats) agreed to purchase Reay's Ranch Markets contingent upon consent by the Landlord to an assignment of the Lease. Reay's Ranch

Markets was unwilling to sell to Wild Oats without being completely released from the Lease.

9. On June 30, 1997, the Landlord and Wild Oats entered into a contract entitled "Amendment of Lease Agreement, Consent to Assignment and Estoppel Certificate" ("Lease Amendment")(ex 2). The Lease Amendment is a valid and binding contract, which released Reay's Ranch Markets from its obligation under the Lease.

10. Wild Oats began operating a specialty grocery store in the Center on July 1, 1997, and ceased operations in early November 1998. Wild Oats then changed the name of its store to "Farm to Market" and on November 12, 1998, began operating a specialty grocery store in the Premises under the name "Farm to Market."

11. On October 20, 1998, Plaintiffs consented to Wild Oats closing its store for up to 30 days to remodel and convert the premises to a Farm to Market store.

12. Wild Oats completely ceased operations in the Premises on January 3, 1999.

13. On June 6, 2000, a proposal was made for a lease of the Premises to Keil's for a term of six years at $4.75 per square foot (Exhibit 278). On July 17, 2000, a letter of intent was signed with Keil's for the Premises for the entire remaining period of the master lease at $5.50 per square foot for the first five years and $6.25 per square foot for the remaining term (Exhibit 281).

14. Keil's began operating a specialty grocery store in the Premises on March 4, 2001. Keil's traffic counts were low from the beginning and it ceased operating on June 20, 2001.

15. Wild Oats had negotiated a sub-lease with Keil's without

the necessity for a buyout of Arizona Health Foods' lease. Plaintiffs bought out Arizona Health Foods' lease to accommodate Keil's. Plaintiffs forgave two months' rent and agreed to pay $75,000.00 to Arizona Health Foods to buy out its lease. Wild Oats was not involved in this buyout (Exhibit 287).

16. No tenant has occupied the Premises since June 20, 2001.

17. Wild Oats admits that it is in default under the Lease but denies that it is liable for any consequential damages other than the continued payment of the rent and CAM charges.

18. Wild Oats has continued to pay its rent and common area ("CAM") charges to Plaintiffs since ceasing operations. During 1999, 2000, and 2001, Plaintiffs have had access to the site.

19. Although Plaintiffs had keys to the premises after Wild Oats vacated, they did not utilize Paragraph 22 of the Lease to terminate Wild Oats' Lease.

20. After Wild Oats vacated the premises. Plaintiffs noticed the following:

A. Traffic in the center slowed.

B. More than 50% of the leasable square footage in the Center was empty.

C. Nello's restaurant closed for lunch on weekends.

D. Center Spectrum, a tenant, moved in in late 1998 and was out by March of 1999.

E. Leandra's Dress Shop, which had exercised its option to extend its lease for an additional three years in October of 1998, left the center in April of 1999.

F. Plaintiffs have had difficulty re-leasing the empty side shops.

G. One tenant, PostNet, was given lower than average rent and has not paid rent for the last ten months.

H. The rental rates in the side shops have gone down and more concessions have been required for new tenants.

I. Monet Cleaners became a discount cleaner and on renewal its rent was reduced from $30,184.00 per year to $24,275.00 per year.

21. Nello's refused to extend its lease upon expiration and has been on a month to month lease for nearly a year.

22. Paragraph 24 of the Lease provides that Plaintiffs' remedies are cumulative.

B. Attempts to Mitigate Damages

23. Plaintiffs acknowledge their obligation to mitigate their damages for Defendant's benefit.

24. Both Plaintiffs and Wild Oats have attempted to find replacement tenants for the Premises.

25. Plaintiffs have attempted to mitigate their damages through their brokerage company, C.B. Richard Ellis, and through Mr. Hornaday's efforts including contacts with Trader Joe's, Harvest Markets, and Walgreens.

26. Plaintiffs attempted to enter into a lease with Walgreen's which required the acquisition and demolition of the Coffee Plantation store which Coffee Plantation was unwilling to discuss because of a potential buyout.

27. Plaintiffs had an opportunity to lease 1650 square feet (the Dynasty Jeweler's space) for $18.00 a square foot to Oka-San commencing July 6, 2001, but did not because of the possibility of leasing to Walgreen's. (Exhibit 320)

28. Oka-San would not sign a lease with a clause that they could be moved within the shopping center.

29. Plaintiffs contacted Jimbo's Naturally on February 24, 2000, and Baron's on March 29, 2000, in an attempt to lease the Premises.

30. Defendant offered three business entities as replacement tenants for all or part of the Premises: a U.S.A. Baby franchise, a MacFrugal's store, and Keil's, a specialty grocer.

31. February 4, 1999, Wild Oats proposed a lease with U.S.A. Baby, a franchisee, which sold new and used baby furniture. The lease would have been for a five-year term with one five-year renewal option at $7.00 a square foot. Wild Oats would continue to perform its obligations under its lease.

32. Plaintiffs did not believe that U.S.A. Baby would bring enough foot traffic into the Center. Wild Oats concedes that U.S.A. Baby would not bring as much traffic into the Center as a grocery store.

33. U.S.A. Baby was turned down by Plaintiffs because it would only use half of the Wild Oats' space and it would not draw repeat customers as a grocery store would. (Exhibit 114)

34. Plaintiffs' agent, C.B. Commercial Richard Ellis, found MacFrugal's as a prospective tenant and presented it to Plaintiff's representative, Mr. Hornaday, who rejected it.

35. MacFrugal's is a $3,000,000,000.00 company with 2800 stores throughout the nation. It is considered a Class A tenant.

36. Mr. Hornaday testified that even though MacFrugal's would bring more foot traffic to Ahwatukee Square, it would not help the "side shops."

37. C.B. Commercial then presented MacFrugal's to Wild Oats which proposed that the space be sublet to MacFrugal's.

38. On December 1, 1999, MacFrugal's signed a letter of intent for a six-year lease with a five-year option at $6.00 per square foot (Ex 269). Wild Oats had the approval of the real estate department of MacFrugal's to proceed.

39. After conferring with their remaining tenants, Plaintiffs rejected MacFrugal's on December 10, 1999, because of the quality of their operation and clientele.

40. Plaintiffs have been unwilling to put anything in the Premises other than a grocery store.

41. A proposed IGA store to be operated by Ira Katz did not go forward because Fleming Foods would not guarantee the lease. Wild Oats is not responsible for the inability of Mr. Katz to lease the Premises.

42. Plaintiffs consented to Keil's as a sub-tenant.

<u>Damage Factors</u>

<u>1. Plaintiffs' Evidence</u>

43. Plaintiffs testified that their opinion of the value of the Center in November of 1998, was $6,700,000.00 to $7,000,000.00, based on the Newquist valuation, but its value now is in a range of $4,500,000.00 to less than $4,900,000.00.

44. The Newquist valuation (Exhibit 194) used higher rents and an 8.75% capitalization rate to arrive at a value of $6,820,194.00, even though the center across the road, with a Basha’s and an Osco’s had been appraised using a 9.5% to a 9.75% capitalization rate.

45. Newquist, a senior vice-president for C.B. Richard Ellis Real Estate Brokers, used an 8.75% capitalization rate to arrive at his conclusion of value because Plaintiffs asked him to obtain the highest value possible.

46. Exhibit 11 is an August 21, 1996, appraisal of the Center which at the time was fully occupied. The appraisal was $5,500,000.00, using a capitalization rate of 10.25%, primarily because: "The property did not have a significant base of national credit tenants and the anchor for the property (Reay’s Ranch Market) is a small local/regional grocer."

47. Plaintiffs' expert, Paul Johnson’s, opinion is that there has been a diminution in value of $1,525,000.00 of the Center. He valued the Center before the breach (January 3, 1999) at $6,400,000.00 and the value after the breach (April 20, 2001) at $4,875,000.00.

48. Paul Johnson used a lease rate for the Premises of $5.50

rather than $8.50, which is being paid, a vacancy rate of 7% and a capitalization rate of 10.5% to arrive at an April 22, 2001 valuation of $4,875,000.00. (ex 310)

49. He used Loan's Nails rental rate of $15.00 per square foot in performing his appraisal. Loan’s Nails rental rate is $15.00 per square foot for the first year of its term but it escalates annually to $16.88 per square foot in the fifth year (ex 89).

50. Plaintiffs did not supply Oka-San's proposed lease with a rental rate of $18.00 per square foot to Mr. Johnson.

51. Paul Johnson testified that he would not consider Oka-San's proposed $18.00 per square foot rent because it was above market and the lease was never executed.

52. Mr. Johnson's analysis did not use the actual rent being paid for the Premises; i.e., it used $5.50 per square foot instead of $8.50 per square foot, which Wild Oats was paying, because a lender would not consider any above-market rent.

53. Paul Johnson did not rely on the Timberline or Alro offers in reaching his conclusions.

54. Paul Johnson’s January 3, 1999, valuation is not an appraisal. At the time he rendered that valuation, he was not aware that Wild Oats was planning to close its store.

55. Had he known that Wild Oats was going to go dark, Paul Johnson would have used a higher capitalization rate and the value of the Center would have been very close to the April, 2001 value.

56. Paul Johnson was not asked to evaluate the effect of a MacFrugal's tenancy on the value of the Center.

57. Paul Johnson's April 20, 2001, analysis (Exhibit 310) was done as if there never could be an anchor tenant in the Center.

58. The anchor tenant was very important to Greg Hjartarson, the owner of Dynasty Jewelers. He was happy with Wild Oats as an anchor because it attracted people with discretionary income.

59. Within nine months after Wild Oats closed, people stopped coming to Dynasty Jewelers. Dynasty Jewelers would have stayed in the Center if Wild Oats had stayed. Dynasty Jewelers' sales increased in 1999 partially because one client purchased $45,000.00 to $50,000.00 in jewelry.

60. Plaintiffs had a personal guarantee from Mr. Hjartarson but did not pursue him for damages for breach of lease and do not claim Dynasty Jewelers' failure to pay rent as part of its damages.

2. Defendants' Evidence

60. James Lee, the former president and chief operating officer of Wild Oats, testified that Wild Oats and the Farm to Market stores were closed because they were losing money.

61. Mr. Lee testified that he felt there was an inherent weakness in Ahwatukee Square and knew of no other grocer in Phoenix who would have an interest in the Premises.

62. Defendants' expert, Elliott Pollack, was retained to determine the timing of damages, if any, from the close of the Farm to Market store. The 1999 capitalization rate used by Paul Johnson (9.5%) was aggressive in that it was the one used for an institutional quality center.

63. He testified that a sophisticated buyer would have known on January 3, 1999, that the Center had problems.

64. Mr. Pollack conceded that he did not take into account individual reasons for some stores' sales increases after the closure of Farm to Market such as a special purchaser in Dynasty Jewelers and that Coffee Plantation sales could have increased because after Farm to Market closed it was the only coffee shop in the Center.

65. Mr. Pollack also did not consider that Block Busters still has the ability to terminate its lease because of the anchor tenant vacancy and that Nello's has refused to renew its lease and is now a month to month tenant.

66. He testified that a grocery tenant would not be successful in the Premises.

67. In the first half of 1999, according to the Delta Associates Survey, an anchored grocery store have a capitalization rate of 9.28% and an unanchored, 10.2%.

68. Mr. Pollack acknowledged that Newquist's use of $7.50 per square foot for the Premises would have undervalued the property because the rent is currently $8.50 per square foot.

69. Mr. Pollack's conclusion that there were no damages as a result of the closure of Farm to Market is rejected because of errors in Mr. Pollack's calculations, he did not interview any of the tenants who were there before and after to determine the nature of the impacts that might not have been reflected in the raw numbers, and he did not take stigma damages into account. Mr. Pollack did not perform an appraisal of the value of the Center before or after. Mr. Pollack did not take into account or give sufficient weight to the closure of Dynasty Jewelers, Photo Express, Leandra’s Dress Shop, Center Spectrum, and Sports Corner. He did not have all the data that he needed to draw his conclusion. (exs 279 and 335)

70. The Court does not accept Mr. Pollack's conclusion that there was no causal connection between the loss of business in the side shops and the closure of Farm to Market.

3. The Court's Analysis

71. The actual rents in the Center since January 3, 1999, have increased primarily because of cost of living and rent escalation clauses in the leases in the Center. The increase has no relation to Wild Oats’ breach of the continuous occupancy clause.

72. Defendant’s argument that the Center would not have had greater foot traffic if Wild Oats continued to operate is not supported by the facts produced at trial.

73. Plaintiffs’ tenants have lost business and turned over due to Wild Oats’ failure to continuously occupy the Premises. For example, Dynasty Jewelers sales went up for six months after Wild Oats left but then went down as a result of the decrease in foot traffic in the Center. Mr. Hjartarson testified that there was very little traffic in the Center after Wild Oats closed. Other tenants left the Center and Post Net has not been able to pay rent for ten months.

74. The question then is: How does one quantify plaintiffs’ damages?

    A. The Court finds that Plaintiffs’ damage claim is inflated. It does not accept Mr. Johnson’s January 3, 1999, capitalization rate of 9.5% as a starting point for the calculation of plaintiffs’ damages. First, the capitalization rate used in the 1996 appraisal, when the Center was fully occupied, was only 10.25%. The Court sees no justification for a .75% change in the capitalization rate in the intervening three years, even though a local tenant (Reay’s) was replaced with a national credit tenant (Wild Oats). This is particularly true because the national tenant was about to close due to poor performance, which was not known to Mr. Johnson when he selected his 9.5% capitalization rate. Had this fact been known, Mr. Johnson would have used a higher capitalization rate. Second, comparable sales do not support a value of $6,400,000, but rather a value between $5,000,000.00 and $5,500,000.00.

B. The application of a 10.25% capitalization rate to the January 3, 1999, stabilized pro forma rents of $608,775 yields a pre-breach value of $5,939,268.00, which is generous.

C. In calculating an April 20, 2001 value the Court added $3.00 per square foot ($78,483) to the "Sub-anchor" gross annual rent and $4950.00 ($3.00 per square foot X 1650 square feet for Oka-San's proposed lease) to the "Shops" gross annual rent for a total rent of $638,713 to which it applied the same 7% vacancy figure to arrive at an annual rent of $589,353.00.

D. Applying a 10.5% capitalization rate to this figure yields an April 20, 2001, value of $5,612,886. The Court feels justified in using a 10.5% capitalization rate because of the deleterious effect that Defendant's breach of the continuous occupancy clause has had on the Center.

E. This analysis results in damages of $326,382.00 ($5,939,268.00 - $5,612,886.00) which the Court feels is a fair measure of plaintiffs' damages, considering that Wild Oats is still liable for and continues to pay rent and plaintiffs have the flexibility to convert the Premises to another higher foot traffic use.

F. The Court finds that plaintiffs made a commercially reasonable effort to mitigate their damages under the circumstances.

Conclusions of Law

1. Wild Oats breached the Lease by failing to honor the continuous operation clause.

2. Plaintiffs’ have been damaged and their damages were proximately caused by Wild Oats' breach of Lease.

3. No Arizona case prevents the recovery of damages for diminution in value of a shopping center for the breach of a continuous occupancy clause. This Court finds the reasoning of the Supreme Court of Tennessee in BVT Lebanon Shopping Center, Ltd. V. Wal-Mart Stores, Inc 48 S.W.3d 132, 135-136 (Tenn.2001) compelling on this issue. See also, Hornwood v. Smith’s Food King No.1,772 P.2d 1284, 1286 (Nev.1989).

4. While it is true that in Arizona contract damages are usually measured as of the date of the breach, in this case the damages to plaintiff are of a continuing nature.

5. The Plaintiffs did not fail to mitigate their damages by rejecting a MacFrugal's store and a U.S.A. Baby franchise. The use clause in the Wild Oats lease calls for a grocery store, and plaintiffs were not required to accept a smaller tenant, (U.S.A. Baby) or a tenant which was objectionable to other tenants in the Center. (MacFrugals) Plaintiffs were entitled to consider the tenant mix at Ahwatukee Square, in determining not to lease to MacFrugal’s, or a U.S.A. Baby franchise. Plaintiffs’ efforts in attempting to re-let the Premises were reasonable. Campbell v. Westdahl, 148 Ariz. 432, 436, 715 P. 2d. 288 (App.1985) and Cafeteria Operators,

L.P. v AMCAP/Denver Limited Partnership, 972 P.2d 276, 279 (Colo. App. 1998).

6. The remedies provisions of the Lease do not prevent Plaintiffs from recovering damages for the breach of the continuous occupancy clause in the Lease.

7. Plaintiffs are entitled to judgment against defendant in the sum of $326,382.00 plus their attorneys' fees and costs.

8. Plaintiffs are entitled to judgment on defendant's counterclaim.

9. Plaintiffs shall submit an application for attorneys' fees and a form of judgment.