Outlet lawsuits highlight the need to update leases

Landlords and tenants have a shared interest in explicitly recognizing the essential value of MFO merchandise.

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ONE OF THE DISTINGUISHING features of outlet leases is the specific requirement in use provisions that the majority of the merchandise must be offered for sale at discounted rates. This is done to support the value proposition of the outlet center, but defining "discount" can be troublesome.

Many leases require that a certain percentage of merchandise be sold at a substantial discount from similar items in full-price stores. Some lease provisions even require dual pricing on the ticket, whereby tenants must show both the Manufacturers' Suggested Retail Price and the discounted outlet price. Although the requirement begets a price-to-price comparison for the same or similar goods, merchandise sold in today's outlet stores is no longer limited to last season's full-price items, close-outs or seconds. Outlet inventory now often includes merchandise specifically made for the tenant's outlet chain.

As outlet tenants began to shift toward more made-for-outlet merchandise, many realized that some of the language in these leases doesn't properly reflect their inventory mix and methods of operation.

Commonly, a tenant might agree to sell merchandise at "less than full retail price" or even at a minimum discount off full price. For example, a use clause might provide that at least 75 percent of merchandise shall be sold at a discount of at least 25 percent. Many retailers object to these requirements and agree only to more generic statements, such as "off-price" or "discounted" or "sale and display of off-price or value-oriented merchandise."

This approach hews more closely to the reality of the situation, which is that MFO merchandise might not be the same as full-price merchandise.

MFOs and lawsuits

The change in outlet merchandising and pricing is catching up to some retailers through consumer lawsuits, and adjusting the use clause to conform to this new reality still might not shield tenants from legal problems.

In mid-to-late 2014, several class-action lawsuits were filed in New York and California on behalf of consumers claiming to have been harmed by retailers' "deceptive and misleading labeling and marketing of merchandise" sold at outlet stores. Lawsuits have been filed against Gap, Neiman Marcus, Michael Kors, Nordstrom and several other retailers.

In these lawsuits, the plaintiffs claim that they were misled in two ways:

(1) the products were manufactured specifically for the outlet stores, and were never sold in full-price stores

(2) the products bear price tags with false MSRP prices listed as comparison pricing for the outlet store prices.

In the lawsuits, the plaintiffs include photographs of price tags that use language such as "MSRP" or "Compare At" to indicate the full price of the item, then list "Our Price" or "60% Savings" next to a lower price to indicate the outlet discount. The plaintiffs claim they were misled by the false comparison and fraudulently induced to make purchases they wouldn't otherwise have made.

The cases all focus on outlet stores in California, which has many consumer-friendly laws. One false-advertising law specifically prohibits retailers from using comparison pricing for a product unless the former price was actually the market price for that product in the previous three months.

The majority of these cases were filed by two law firms, and at least two of the cases feature the same lead plaintiff. This signals that law firms are potentially seeking out plaintiffs for class-action lawsuits, and they might be seeking plaintiffs to file similar lawsuits against additional outlet retailers. Although all of these cases have related to conduct in California, the trend could spread to other states with similar consumer protection laws. As of VRN press time in late March, no judgments had been issued on these cases by any of the courts.

The MFO challenge

These lawsuits create new challenges for outlet retailers, including how, or whether, to conduct price-to-price comparisons for MFO inventory. Although landlords might not have the same legal concerns as tenants in these cases, they clearly have a stake in ensuring that the current system of specialized manufacturing for outlet stores remains viable. Without MFO goods, the number of brands with enough liquidation merchandise to support a chain of outlet stores would face a precipitous drop.

Clearly, both landlords and tenants have a huge stake in the outcome of these cases. If the plaintiffs prevail, it will undoubtedly have a large ripple effect on how tenants advertise and merchandise their outlet stores.

Even if the plaintiffs don't win, landlords still face pressure to modify the use and operation clauses to ensure that tenants don't run afoul of legal requirements regarding how they conduct their business. Tenants should make sure their lease obligations don't expose them to similar lawsuits.

It is time for landlords and tenants to take a fresh look at their outlet use provisions so that the lease language reflects actual merchandising and sales practices. Furthermore, the definition of "discount" must be expanded to include MFO merchandise.

Both parties have the same goal: preserving the value proposition – the very definition of outlet shopping – without triggering legal challenges.

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