Shop Covenants in Retail Leases: Strategic Use, Enforcement Trends, and Drafting Considerations

Insights • July 6, 2026

“Shop covenants” (also commonly referred to as continuous operation covenants) remain a foundational component of many retail leases, particularly in shopping centers, mixed-use developments, outlet centers, and other foot-traffic-driven retail environments. These provisions generally require a tenant to continuously operate its business from the leased premises during specified hours and in accordance with defined operational standards.

While shop covenants in retail leases have existed for decades, their practical significance has evolved considerably in recent years. Modern retail realities, including e-commerce disruption, omnichannel fulfillment models, changing consumer behavior, and shifting economics surrounding physical storefronts, have forced both landlords and tenants to rethink how these provisions are drafted, negotiated, and enforced.

For landlords, shop covenants remain essential to preserving the overall health and economic ecosystem of a retail property. For tenants, however, these provisions can create meaningful operational rigidity at a time when flexibility is increasingly viewed as a business necessity.

As a result, retail lease negotiations have increasingly shifted away from whether continuous operation obligations should exist at all, and toward how the economic consequences of non-operation should be structured.

Why Shop Covenants Matter in Retail Leasing

Retail leasing differs fundamentally from office and industrial leasing because the success of one tenant often directly impacts the performance of others within the same property.

A dark storefront does not simply affect the tenant occupying the space. It can reduce foot traffic, negatively impact neighboring tenants, weaken the overall tenant mix, and diminish the perceived vitality of an entire shopping center or development.

For landlords, shop covenants in retail leases are intended to protect against precisely those risks.

These provisions commonly serve several interconnected objectives:

Preservation of Foot Traffic

Retail centers rely heavily on customer movement and visibility. Vacant or dark spaces can interrupt customer flow patterns and discourage visitors from spending time within the property.

Protection of Percentage Rent Structures

Where leases include percentage rent components, continuous operation directly impacts a landlord's revenue stream. A non-operating tenant may continue paying base rent while substantially reducing the landlord's overall economic return.

Maintenance of Tenant Mix and Merchandising Strategy

Many retail developments are intentionally curated to create a specific customer experience or merchandising balance. Dark spaces can undermine that strategy and weaken the synergy between tenants.

Avoidance of "Ghost Space"

Even where rent continues to be paid, vacant storefronts often create a perception of decline within a property. This can affect leasing efforts, renewal negotiations, financing considerations, and overall asset value.

Because of these concerns, shop covenants remain particularly prevalent in:

- Regional malls
- Outlet centers
- Grocery-anchored shopping centers
- Urban retail corridors
- Mixed-use retail developments

Typical Structure of Shop Covenants in Retail Leases

Although the specific language varies significantly by transaction, most shop covenants address several recurring operational components.

Continuous Operation Obligations

At the core of most provisions is a requirement that the tenant open for business by a specified date and continue operating throughout the lease term, subject to negotiated exceptions.

Landlords often seek broad language requiring uninterrupted operation, while tenants typically negotiate carve-outs for remodeling, casualty events, force majeure circumstances, temporary closures, staffing issues, or business restructuring initiatives.

Required Hours of Operation

Retail leases frequently require compliance with center-wide operating hours. These provisions are designed to ensure consistency throughout the property and maintain predictable customer activity during peak shopping periods, weekends, and holidays.

For tenants, however, rigid operating hour requirements can become problematic when store-level profitability fluctuates or consumer traffic patterns evolve.

Permitted Use and Operational Standards

Many shop covenants are tied directly to the lease's permitted use clause. In addition to simply remaining open, tenants may be required to operate in a manner consistent with a defined brand standard, merchandising level, or quality threshold.

Some leases further require tenants to maintain a "first-class" operation, though disputes often arise regarding how subjective standards like this should be interpreted.

Inventory and Staffing Requirements

Certain retail leases also include minimum inventory or staffing obligations intended to prevent a tenant from technically remaining open while operating at a substantially reduced level.

These provisions can become particularly contentious during periods of economic uncertainty or broader shifts in consumer demand.

Enforcement Challenges and Landlord Remedies

Although landlords often negotiate aggressive operational requirements, courts have historically been reluctant to force tenants to continue operating businesses against their will.

As a practical matter, this has caused enforcement efforts to shift away from operational compulsion and toward economic remedies.

Recapture Rights

One of the most common landlord remedies is a recapture right, allowing the landlord to terminate the lease and repossess the premises if the tenant ceases operations.

From a landlord perspective, recapture rights can provide flexibility to replace non-operating tenants and avoid prolonged dark space within the property.

"Going Dark" Rent and Liquidated Damages

Many modern retail leases now include enhanced rent structures triggered by a tenant ceasing operations.

These provisions may require payment of:

- Increased fixed rent
- Substitute percentage rent
- Rent tied to historical sales performance
- Liquidated damages formulas

The enforceability of these provisions often depends on whether the amounts represent a reasonable estimate of anticipated damages rather than an impermissible penalty.

Default and Cross-Default Provisions

Failure to comply with shop covenants may also trigger broader lease defaults, including defaults under guaranties, related leases, or financing arrangements tied to the retail property.

Injunctive Relief

Although many leases expressly provide for injunctive relief, courts rarely compel tenants to actively operate retail businesses.

Judicial reluctance generally stems from concerns regarding:

- Ongoing court supervision of business operations
- Forcing economically irrational conduct
- Treating retail operations as a form of personal service obligation

As a result, even where leases authorize equitable remedies, courts overwhelmingly favor monetary relief over specific performance.

Evolving Enforcement Trends and National Case Law

Recent case law involving shop covenants in retail leases reflects several broader themes that continue to shape retail leasing negotiations nationwide.

Courts Continue to Resist Compelling Operation

A strong national trend persists: courts generally do not want to supervise the day-to-day operation of retail businesses.

Many decisions emphasize that forcing tenants to operate at a loss is commercially unreasonable and inconsistent with broader principles governing equitable remedies.

In practice, this means that landlords relying primarily on injunctive relief often face significant enforcement challenges.

Increased Scrutiny of "Penalty Rent" Provisions

Courts are also increasingly focused on whether liquidated damages and "going dark" rent provisions represent reasonable estimates of anticipated harm.

Recent decisions suggest that courts are less willing to enforce formulas that appear punitive, arbitrary, or disconnected from actual economic loss.

Several factors may influence enforceability, including:

- Whether damages were difficult to estimate at lease execution
- Whether the formula reasonably approximates anticipated harm
- Whether the landlord controls triggering conditions
- Whether the remedy is disproportionate to the actual impact of the closure

This trend has pushed many landlords toward more carefully calibrated economic remedies.

No Implied Continuous Operation Obligations

Another consistent principle remains firmly intact across jurisdictions: courts generally will not imply a continuous operation obligation unless the lease expressly creates one.

Percentage rent provisions, exclusivity clauses, or broad use provisions are typically insufficient standing alone.

Only in limited circumstances (i.e., those often involving leases with nominal base rent and heavy reliance on percentage rent) have courts entertained implied operational obligations.

The drafting takeaway is straightforward: If continuous operation is important, the lease must say so clearly and explicitly.

Broader Restrictive Covenant Principles Are Influencing Retail Leasing

Courts increasingly analyze shop covenants through the broader lens of restrictive covenant jurisprudence.

That means judges are placing greater emphasis on:

- Narrow tailoring
- Legitimate business justification
- Commercial reasonableness
- Proportionality

Overly aggressive provisions may face heightened scrutiny, and some courts have shown less willingness to "blue pencil" or reform overbroad drafting.

This trend extends beyond shop covenants themselves and increasingly affects:

- Radius restrictions
- Exclusive use provisions
- Co-tenancy obligations
- Operational restrictions

Modern Retail Realities Are Reshaping Judicial Perspectives

Courts are also increasingly acknowledging broader shifts in the retail landscape.

Modern retailers may use physical locations for purposes extending beyond traditional in-store sales, including:

- Brand visibility
- Customer acquisition
- Product showrooming
- Fulfillment and logistics support
- Omnichannel integration

These evolving business models reinforce judicial hesitation toward rigid operational requirements rooted in older retail assumptions.

The Shift Toward a "Pay-to-Go-Dark" Framework

Taken together, modern enforcement trends reflect a practical evolution in retail leasing: Courts are increasingly endorsing a model in which tenants may cease operations, provided they compensate landlords through negotiated economic mechanisms.

This has accelerated the use of:

- Enhanced rent structures
- Negotiated go-dark rights
- Flexible recapture provisions
- Economic exit frameworks

As a result, many retail lease negotiations now focus less on whether a tenant can go dark and more on what financial consequences will apply if it does.

Tenant Pushback and Current Negotiation Trends

Tenants (particularly sophisticated national retailers and credit tenants) continue to negotiate aggressively against strict operational obligations. Common negotiation trends include:

Express Go-Dark Rights

Many tenants now seek explicit contractual rights to cease operations while continuing to satisfy economic lease obligations.

Sales Threshold Termination Rights

Tenants increasingly negotiate kick-out rights tied to underperformance metrics or minimum sales thresholds.

Co-Tenancy Protections

Retailers often condition operational obligations on the continued presence of anchor tenants or minimum occupancy levels within the center.

Omnichannel Flexibility

Tenants frequently seek operational flexibility acknowledging that stores may function as hybrid retail, branding, or logistics locations rather than purely revenue-generating storefronts.

Drafting Considerations for Landlords and Tenants

Given current enforcement trends, careful drafting has become increasingly important.

Considerations for Landlords

Landlords should consider:

- Anchoring remedies to demonstrable economic loss
- Avoiding punitive or arbitrary liquidated damages structures
- Including streamlined and clearly defined recapture rights
- Coordinating shop covenant provisions with co-tenancy clauses
- Drafting operational requirements narrowly and precisely

Overly aggressive drafting may increase invalidation risk and reduce enforceability.

Considerations for Tenants

Tenants should evaluate:

- Whether operational obligations reflect current business realities
- Economic exposure under substitute rent provisions
- Flexibility surrounding hours of operation and staffing requirements
- Appropriate carve-outs for remodeling, casualty, force majeure, and supply chain disruptions
- Co-tenancy protections tied to continued operation obligations

Careful negotiation can help balance operational flexibility with a landlord’s legitimate interest in maintaining an active retail environment.

Key Legal and Practical Takeaways

Several themes increasingly define the modern treatment of shop covenants in retail leases:

- Courts remain reluctant to compel tenants to actively operate retail businesses
- Economic remedies are generally favored over specific performance
- Liquidated damages provisions must be commercially reasonable and defensible
- Ambiguity typically favors tenant flexibility rather than implied landlord expectations
- Modern retail leases increasingly rely on economic incentives rather than rigid operational mandates

Conclusion

Shop covenants continue to play an important role in preserving the vitality and economic stability of retail properties. However, both the retail industry and judicial treatment of these provisions have evolved significantly.

Today, the practical strength of shop covenants in retail leases often lies less in forcing a tenant to remain open and more in structuring the financial consequences of going dark.

For landlords, this means focusing on carefully calibrated economic remedies, commercially reasonable drafting, and flexible recapture mechanisms. For tenants, it means ensuring that operational obligations align with modern retail realities and evolving business models.

In an environment where courts increasingly prioritize proportionality, economic realism, and practical enforceability, thoughtful and market-informed drafting remains the most effective tool for minimizing disputes and aligning long-term interests.

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