UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

IROQUOIS MANOR, et al. PLAINTIFFS

v. CIVIL ACTION NO. 3:99CV-27-S

WALGREEN CO. DEFENDANT

MEMORANDUM OPINION

This matter is before the Court on motion of the plaintiffs, Iroquois Manor, et al. ("Iroquois Manor"), for judgment on the pleadings. At issue is whether the defendant, Walgreen Co. ("Walgreen"), breached its lease with Iroquois Manor when it vacated the premises and discontinued its payment of cash sales percentage rent, but continued to pay the fixed monthly rent. For the reasons set forth below, the plaintiffs' motion will be denied.

FACTS

On July 18, 1950, Iroquois Manor, as landlord, and Walgreen,[1] as tenant entered into a twenty year lease for retail space in the Iroquois Manor Shopping Center in Louisville, Kentucky. The lease's rent clause provided as follows:

> 1. Tenant shall pay a fixed rent as follows: $875.00 per month for the period commencing on the date Tenant opens its store for business . . .
> 20. If a sum equal to three and one-half (3 ½) per cent of the cash receipts of sales, as hereinafter defined, made by Tenant in the operation of Tenant's drug store on the leased premises in any twelve months period during the term hereof, beginning with the date Tenant opens its store for business, shall exceed the total fixed monthly rental under Article 1 for such twelve months period, then and in such event Tenant shall pay the Landlord the amount of such excess as additional rent.

The parties modified the 1950 lease several times during the forty-seven year relationship. A chart outlining the modifications follows:

[1] Iroquois Manor is the successor to Suburban Stores, Inc., referred to as "Landlord" in the original July 18, 1950 lease. Walgreen Co. is the assignee of Walgreen Drug Stores, Inc., referred to as "Tenant" in the original lease.

	Original Lease: 07/18/1950	**First Modification 03/16/1955**	**Second Modification 05/20/1959**	**Third Modification 02/03/1981**	**Fourth Modification 03/12/1987**
Term of Years	20 Year Term: 02/1/1951 to 01/31/1971	Expiration Date of 01/31/1971 extended to 07/31/1975 (4 yrs 6 mon)	Expiration Date of 07/31/1975 extended to 01/31/1985 (9 yrs 6 mon)	Expiration Date of 01/31/1985 extended to 01/31/2000 (15 yrs)	No change in expiration date
Property Description	45 ft of frontage on 3rd Street, 125 feet frontage on Southland Blvd	900 square feet added to existing property	3070 square feet added	3880 square feet added	752 square feet added
Base Rent	$875.00 per month	Increased to $1,125.00 per month	Increased to $2,000 per month	Increased to $5612.08 per month	Increased to $7,500 per month
Percentage Rent	3.5% of cash receipts of sales per year exceeding total yearly base rent	Changed to 3.5% of cash receipts of sales up to $500,000 plus 2.5% of cash receipts of sales in excess of $500,000	Changed to 3% of cash receipts of sales up to $800,000 plus 2.5% of cash receipts of sales in excess of $800,000	Changed to 3% of cash receipts of all sales	No change in Percentage Rent amount

As outlined above, all modifications were made prior to the expiration of the lease term, and with all but one modification, the parties created a new expiration date. With every modification the base rent was increased substantially. For example, after a modification in 1981, the base rent was increased over 250 percent. The percentage rent was also changed in all but one modification.

Walgreen occupied this space continually until June 1998 when it vacated the premises and opened a new store across the street. Walgreen continued to pay the fixed monthly rent, but

did not pay the percentage rent. Walgreen also refused to allow Iroquois Manor to lease the premises, presumably because Iroquois Manor would have likely leased the space to a competing drug store.

STANDARD OF REVIEW

A motion for judgment on the pleadings is granted only where "no material issue of fact exists and the party making the motion is entitled to judgment as a matter of law." Paskvan v. City of Cleveland Civil Serv. Comm'n, 946 F.2d 1233, 1235 (6th Cir. 1991). In considering the motion, the Court must take all well-pleaded material allegations in Walgreen's answer as true. United States v. Moriarty, 8 F.3d 329, 332 (6th Cir. 1993). The pleadings upon which this Court must base its opinion include the lease at issue, which is incorporated into the complaint.

DISCUSSION

Neither the original lease nor the subsequent modifications, which incorporate the original lease terms, contain an express covenant requiring continuous occupation of the leased premises by Walgreen. Thus, in order to determine that Walgreen breached its lease with Iroquois Manor, this Court would first have to imply covenants of continuous operation into some or all of the leases. The plaintiff urges that we do so.

Under Kentucky law, implied covenants are those which "may reasonably be inferred from the whole agreement and the circumstances attending its execution." Anderson v. Britt, 375 S.W.2d 258, 260 (Ky. Ct. App. 1963). Because implied covenants are not favored in the law, courts should imply them only when it is necessary to carry out the purpose of the contract. Id. at 260-61. Thus, the focus of this inquiry is the intent of the parties. In the case at hand, we will look to the original lease and the modifications to determine whether or not to imply a covenant of continuous operation.

Walgreen argues that we should not imply the covenant because this case involves two sophisticated commercial parties who repeatedly and actively negotiated the lease throughout the

years. We agree. The active negotiation in this case cannot be overstated. This lease was modified several times very early in the relationship, and the parties never waited for the lease term to expire. With every modification, Iroquois Manor and Walgreen increased the base rent and adjusted the percentage rent. In the 1981 and 1987 modifications, the parties increased the fixed base rent substantially, from $2,000 to $5,612.08 to $7,500. Thus, Iroquois Manor boosted its guarantee with every modification.

Furthermore, the percentage rent clause in the lease begins with the word "if." The use of that word suggests the parties intended the percentage rent to be a conditional term. Thus, under this lease there are two potential rents payable: the fixed base rent and the additional percentage rent. The fixed rent is a guarantee; the additional rent is a bonus.

The plaintiffs rely heavily upon Lagrew v. Hooks SupeRx, Inc., 905 F. Supp. 401 (E.D. Ky. 1995), as support for their argument that this Court should imply a covenant of continuous operation into the lease at issue. Initially, we note that decisions of co-ordinate federal courts are not binding on this Court. We find the facts of Lagrew to be distinguishable, however, from those in this case.

First, the amount of base rent amount being paid by SupeRx was unchanged for twenty-three years. SupeRx was obligated to pay the same amount of base rent in 1991 as in 1966. The parties in Lagrew never changed or renegotiated the original lease. In contrast, the parties here have repeatedly increased the base rent, changed the percentage rent, and added square footage.

Second, in Lagrew, the lease was for fifteen years with three five year renewal options. After the initial fifteen years expired without modification, SupeRx exercised two of the five year options. With two years remaining on the second option, SupeRx closed its doors and moved. Despite this move, SupeRx exercised its third renewal option on the lease. Thus, in Lagrew, the Court was dealing with options built into the original agreement, the exercise of which required

no additional bargaining by the parties. In this case, we are dealing with modifications resulting from subsequent negotiation, all of which were made prior to the natural expiration of the lease.

We view the express, written terms of the lease agreement to be dispositive of whether Walgreen has an obligation of continuous operation. The active negotiations over time indicate that, if the parties intended for Walgreen to continuously occupy the premises, they could and would have inserted such a clause into the original lease or any of the four modifications. We do not believe that inference of such a covenant is necessary in order to effectuate the full purpose of the contract as a whole. Neither the original lease nor the subsequent modifications reveal bargaining positions so unequal as to justify the Court adding unstated language to some or all of the lease documents. For the foregoing reasons, we decline to imply a covenant of continuous operation. A separate order will be entered herein in accordance with this opinion.

This _____ day of _____, 1999.

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CHARLES R. SIMPSON III, CHIEF JUDGE
UNITED STATES DISTRICT COURT

cc: Counsel of Record

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ORDER

Motions having been made by the plaintiffs, Iroquois Manor, et al., for judgment on the pleadings and for oral argument, and for the reasons set forth in the memorandum opinion entered herein this date, and the Court being otherwise sufficiently advised, **IT IS HEREBY ORDERED AND ADJUDGED** that:

1. The plaintiffs' motion for judgment on the pleadings is **DENIED**.
2. The plaintiffs' motion for oral argument is **DENIED**.

IT IS SO ORDERED this _____ day of _____, 1999.

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CHARLES R. SIMPSON III, CHIEF JUDGE
UNITED STATES DISTRICT COURT

cc: Counsel of Record