

**SUPREME COURT - STATE OF NEW YORK
COMMERCIAL DIVISION
TRIAL TERM, PART 44 SUFFOLK COUNTY**

PRESENT: Honorable Elizabeth H. Emerson

GRANFELD II, LLC,

Plaintiff,

-against-

KOHL'S DEPARTMENT STORES, INC. and
KOHL'S ILLINOIS, INC.,

Defendants.

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PROCEDURAL HISTORY

This matter involves issues arising under and in connection with an Agreement of Lease dated October 17, 2003, as amended (the "Lease"), between and among Feldland Management LLC, together with its assignee Grandfeld II, LLC (the "Plaintiff"), as landlord, and Kohl's Department Stores, Inc. together with its assignee Kohl's Illinois, Inc. (the "Defendant"), as tenant. Pursuant to the terms of the Lease, the Plaintiff leased 9.81 acres (the "Premises") located in the Town of Brookhaven (the "Town"), County of Suffolk to the Defendant for an initial term of 20 years. The Lease provided that the Defendant was to construct an 88,400 square foot building on the Premises which the Defendant would operate as a Kohl's department store (the "Building"). The dispute at issue in this litigation arises in connection with the Defendant's right to terminate its obligations under the Lease. Specifically, the Plaintiff alleges that the Defendant breached the Lease when, through correspondence dated January 21, 2009, the Defendant asserted its right to terminate the Lease. As more fully described herein, in that correspondence the Defendant claimed that, as certain Governmental Approvals (as defined in the Lease) had not been obtained on or before January 21, 2009, it had the right to terminate the Lease without further

obligation to the Plaintiff. In making this claim the Defendant relied principally upon provisions set forth in Sections 3.2 and 3.3 of the Lease. Upon receipt of the Defendant's correspondence, the Plaintiff responded by rejecting the Defendant's alleged termination and demanding that the Defendant continue to perform. While the Plaintiff acknowledged that the DOT Permit (as hereinafter defined) from the New York State Department of Transportation (the "DOT") remained outstanding, the Plaintiff asserted, among other things, that the Defendant through its actions regarding the DOT Permit had waived its right to terminate the Lease for that reason. Further, the Plaintiff claimed that the termination was not motivated by the failure to obtain the DOT Permit, but was in fact motivated by the Defendant's desire to scale back its national expansion plans due to a downturn in the U.S. economy. In fact, the Plaintiff alleged that the reason given by the Defendant for termination was a pretext rather than the actual basis for the Defendant's attempted termination.

The matter was tried before the Court, without a jury, on March 5-8 and 12, 2012. At the commencement of the trial the parties submitted a stipulated statement of facts (the "Stipulation") setting forth certain matters which were not in dispute. At the trial the Plaintiff called the following witnesses: (i) Glenn Feldman, a member and principal of the Plaintiff; (ii) Steven Berube, a Senior Permit Expeditor with RMB Development Consultants, Inc.; (iii) Margaret Kelly, a Permit Expeditor Consultant and principal of Kelly's Expediting, Inc.; (v) Jeremy Isaacs of Ripco Real Estate, a New York licensed real estate broker; (vi) Christopher W. Robinson, P.E. of RMS Engineering, Inc., a New York State Licensed civil engineer; and (vii) Richard J. DiGeronimo, a general real estate appraiser certified by the State of New York, who was qualified as an expert witness with respect to the issue of damages under the Lease. The Plaintiff also read excerpts of the deposition testimony of Amy Vecellio, project manager who, as an employee of the Defendant, had oversight responsibility for construction of the Building. The Defendant cross examined the Plaintiff's witnesses and called Andrew Albro, a real estate appraiser, who was qualified as an expert witness with respect to the issue of damages under the Lease. At the conclusion of the trial, the parties were directed to produce the record and to submit post-trial memoranda. On June 13, 2012, prior to the submission of the post-trial memoranda, the court conducted a conference with counsel to the parties. At the conference, it was decided that the interest of the parties would be best served if the court considered the question of liability and reserved on the question of damages. Following the conference, the parties prepared and submitted their memoranda in accordance with this determination. Such memoranda were fully submitted by the parties by the beginning of September 2012.

FACTS

As previously stated, the dispute between the parties centers around the termination provisions of the Lease found in Section 3.2 and Section 3.3 thereof. Section 3.2 provides:

SECTION 3.2: Notwithstanding anything contained in the Lease to the contrary, the obligations of Landlord and Tenant under this Lease shall be contingent upon Landlord obtaining from the Town of Brookhaven all necessary zoning approvals which, in Tenant's sole and

absolute discretion, may be required for Tenant to development of the Premises, the construction and operation of the Building and the use of the Premises for Tenant's intended use (the "Zoning Approval"). Landlord shall apply for the Zoning Approval promptly upon the execution of this Lease. If Landlord does not obtain the Zoning Approval within twenty-four (24) months after the date of this Lease, then either party may terminate this Lease by giving written notice to the other party to that effect prior to the date on which the Zoning Approval has been obtained, whereupon neither party shall have any further liability or obligation to the other hereunder.

Section 3.3 of the Lease provides:

SECTION 3.3: As used in this Lease, the term "Governmental Approvals" shall mean all land use approvals and other approvals which, in Tenant's reasonable discretion, may be necessary for the construction and operation of the Building including, without limitation, zoning variances, site plan approvals, building permits, access and utility easements, side yard agreements and other necessary or required approvals of the Building; provided, however, the term Governmental Approvals shall not include the Zoning Approval. Notwithstanding anything contained in this Lease to the contrary, the obligations of Landlord and Tenant under this Lease shall be contingent upon Tenant having obtained the Governmental Approvals. Tenant shall apply for the Governmental Approvals within thirty (30) days after Landlord has obtained Zoning Approval. If Tenant has not obtained the Governmental Approvals within six (6) months after the date on which Landlord obtains the Zoning Approval, then either party may terminate this Lease by giving written notice to the other party to that effect prior to the date on which the Governmental Approvals have been obtained, whereupon neither party shall have any further liability or obligation to the other. Tenant agrees to use commercially reasonable efforts to make such inquiries, retain such consultants, make such applications and perform such acts as may be reasonably necessary or appropriate to enable Tenant to obtain Governmental Approvals.

The parties agree that the Plaintiff's obligation pursuant to Section 3.2 of the Lease to obtain the Zoning Approval was satisfied as of May 23, 2008 (See paragraph 10 of the Stipulation). The parties also agree that pursuant to Section 3.3 of the Lease the Defendant was obligated to obtain Governmental Approvals on or before December 23, 2008, six months from May 23, 2008 (See paragraph 11 of the Stipulation).

The dispute between the parties focuses on an approval sought from the DOT to construct a curb cut from the rear parking lot of the Premises onto the service road for the Long Island Expressway (the "DOT Permit"). Initially, the parties believed that the DOT Permit would need to be obtained before a building permit would be issued by the Town. At that time, the parties also believed that it was unlikely that the DOT Permit would be obtained before the date on which the Defendant wanted to begin construction of the Building. As the record reflects, commencing construction of the Building on or before a particular date was important to the Defendant. The Defendant, as a national retailer, had established an internal practice of opening new stores only at certain times of the year¹. Such practice was described as an "opening cycle" that was strictly adhered to by the Defendant. This meant that the commencement, and ultimately completion of construction of the Building, had to occur on or before certain dates designated by the Defendant. As a building permit was needed to commence construction, it was important for the Defendant to obtain such building permit on or before a date that would allow it to adhere to its opening schedule. As previously stated, in early summer 2008 both parties believed that the DOT Permit would need to be obtained before a building permit could be issued. Although the process to obtain the DOT Permit was underway and was proceeding without issue, the parties believed that it would not be completed until after the date on which the Defendant had sought to begin construction to meet its opening cycle. Accordingly, the Defendant began to pursue ways to favorably resolve the issue presented by the DOT Permit. Ultimately, upon the advice of various expeditors and experts employed by the Defendant, the Defendant approved an approach that would allow a building permit to issue upon receipt by the Town of a letter from the DOT. To summarize, agents acting on behalf of the Defendant advised the Defendant that the Town would be willing to issue the building permit if it received a letter from the DOT advising the Town that the DOT did not object to the issuance of a building permit. Both the Town and the DOT agreed to adopt this approach. The letter that was ultimately issued by the DOT read as follows:

"Inasmuch as we are in conceptual agreement with the Mitigation measures proposed and believe that all Involved are working diligently towards a resolution That will not compromise public safety on the state highway, we have no objection to the Town of Brookhaven issuing a building permit for this site.

¹ The record contains a lengthy discussion regarding the Defendant's procedures for constructing and opening stores. Both sides argued that this cycle dictated the date by which construction needed to begin and by which a store needed to be ready to open to the general public.

In order to insure that all public safety concerns relating to traffic have been addressed in the final site plans, we request, by copy of this letter, that the Town of Brookhaven contact us prior to the issuance of the certificate of occupancy.”

Following receipt of this letter from the DOT, a building permit was issued by the Town. In fact, the parties agree that a building permit was issued on October 24, 2008 (See paragraph 17 of the Stipulation). Further, the parties agree that, once the building permit had been issued, the Defendant was free to begin construction on the Building. The parties also agree that, despite receiving the building permit and the Defendant’s stated desire to commence construction at the Premises, the Defendant did not commence construction of the Building. In fact, construction was never commenced. The record reveals, however, that agents acting on behalf of the Defendant continued to move forward with the DOT Permit and that, at the time of the Defendant’s purported termination, while items remained outstanding there were no known impediments to obtaining the DOT Permit.

Notwithstanding these facts, on January 21, 2009, the Defendant circulated an internal email indicating that it planned to terminate 23 development projects throughout the country, including the proposed retail store at the center of this litigation. In fact, the Defendant’s email discussing these 23 projects states that “these project(s) have a negative Net Present Value (“NPV”) that’s why each such project made the list.” Finally, the parties agree that on January 21, 2009 the Defendant advised the Plaintiff in writing that it was terminating the Lease in accordance with Section 3.3 thereof in view of the fact that “Tenant had not obtained all of the Governmental Approvals necessary for the construction and operation of the building including, without limitation, applicable permits and approvals from the New York State Department of Transportation.” By correspondence dated February 12, 2009, the Plaintiff’s counsel advised the Defendant that the Plaintiff deemed the Defendant’s January 21, 2009 correspondence to constitute an anticipatory repudiation of the Lease inasmuch as the Defendant had affirmatively sought and received the Town’s deferral of the requirement of the DOT Permit until a date well in excess of the six (6) month Governmental Approval termination date provided for in Section 3.3 of the Lease. The correspondence concluded by furnishing Kohl’s with a thirty (30) day, written notice of its default under the Lease in accordance with Section 19.1(b) thereof. Thereafter, the Plaintiff commenced this litigation.

DECISION

The issue before the court is whether the Defendant’s termination of the Lease was permitted by the terms thereof. Both sides have relied on the circumstances surrounding the DOT Permit to support their respective arguments. The Plaintiff contends that the Defendant’s behavior regarding the DOT Permit constituted a waiver in that the Defendant orchestrated the process to defer receipt of the DOT Permit until well after construction had been commenced and, most likely, substantially completed. The Plaintiff contends that the failure to obtain the DOT Permit was not the reason the Defendant sought to terminate the Lease and that the real reason was set forth in the Defendant’s January 21, 2009, internal email describing its decision to scale

back its expansion plans. In support of this contention, the Plaintiff highlights facts that demonstrate that the parties had every reason to believe that the DOT Permit would be obtained in a timely manner. In addition, the Plaintiff notes that, despite obtaining the necessary Building Permit, no work was ever commenced. Further, the Plaintiff notes that at or about the time the Defendant delivered its purported cancellation, the Defendant also moved to terminate 22 other projects throughout the country. Finally, the Plaintiff notes that the Defendant's internal emails state that all 23 projects singled out for termination were projects with negative "net present value". In response, the Defendant argues that, notwithstanding extraneous circumstances cited by the Plaintiff, the Defendant was within the plain meaning of the language of the Lease, and because the DOT Permit remained outstanding on January 21, 2009, it had the right to terminate its obligations under and in connection with the Lease.

To begin, the court agrees with the contention that the applicable provisions of the Lease are clear and unambiguous. Section 3.3 allowed the Defendant to terminate its obligations under the Lease only if it failed to obtain Governmental Approvals by a date certain. Such a provision is consistent with the sole purpose of the Lease, and the language of the Lease makes it clear that the Defendant's right to terminate is limited to that circumstance. With this in mind, the court finds that the question presented by this litigation is whether the Defendant terminated the Lease because it had failed to obtain the DOT Permit on or before January 21, 2009, or whether it attempted to terminate its obligations under the Lease for other reasons.

The preponderance of the credible evidence in the record demonstrates that the Defendant sought to terminate the Lease for reasons unrelated to the failure to obtain the DOT Permit and that such failure provided a mere pretext for the termination. Careful examination of the record, including the testimony of the credible witnesses and the credible documentary evidence demonstrates that it was the Defendant's decision to scale back its operations throughout the United States by canceling projects and abandoning retail sites that motivated its desire to terminate the Lease. The court finds that the failure to obtain the DOT Permit by January 21, 2009 was not the reason the Defendant sought to terminate the Lease.

While the Defendant's internal email provides powerful insight into its thinking at the time of termination, the facts surrounding the DOT Permit provide even more persuasive evidence. The record reveals that at no time did the parties reasonably believe that the DOT Permit would not be obtained in a timely manner. In fact, the communication from the DOT explicitly stated that the DOT was in conceptual agreement with the request for the curb cut. The only issue regarding the DOT Permit was not whether it could be obtained, but when it would be obtained. This point is highlighted by the action of the parties. The DOT Permit was a relatively minor issue which could have waited until the end of the construction process. Originally the Defendant pursued the DOT Permit in the early stages of the project because it believed that the DOT Permit needed to be obtained before a building permit could be obtained. However, at the request of the Defendant the DOT issued a letter to the Town and the Building Permit was issued on October 24, 2008. As highlighted throughout the record, the Defendant sought aggressively to pursue the approach that deferred receipt of the final DOT Permit until at or about the time the certificate of occupancy was applied for. This meant that on January 21, 2009 the parties were not anticipating receipt of the DOT Permit until the construction was substantially complete. While it

is clear that further work needed to be done before the final permit was issued, there was never an indication that requests by the DOT could not be satisfied or that the DOT Permit would not be issued at or about the time of substantial completion of the Building when it was actually needed.

All of this points to one conclusion. The real reason and the only credible explanation for the Defendant's attempted termination of the Lease on January 2009 was unrelated to the failure to obtain the DOT Permit. The real reason the Defendant sought to terminate the project was the Defendant's overall financial condition and its desire to scale back its plans to construct a new Kohl's department stores. This conclusion is further reinforced by the Defendant's failure to commence construction at the Premises despite its previous desire to begin as soon as possible. Moreover, the Defendant's arguments regarding the DOT Permit were simply an attempt to use form over substance. Accordingly, the Defendant's failure to move forward under the Lease constituted a breach.

In keeping with the court's prior directions, the court reserves on the question of the appropriate measure of damages. The court directs the parties to appear at a conference on March 28, 2013, 11:00 a.m., Supreme Court, Courtroom 7, Arthur M. Cromarty Criminal Court Building, 210 Center Drive, Riverhead, New York 11901 to address all outstanding issues including, without limitation, the question of damages.

Dated: February 4, 2013

HON. ELIZABETH HAZLITT EMERSON

J.S.C.