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Question of the Month: What happens when the tenant fails to exercise the option to renew a lease?

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It's a fairly common occurrence, it happens every day. A tenant decides to renew its lease. Often, this is a simple process, send a letter to the landlord or the landlord's attorney within a pre-determined time period, maybe provide some financial documents, renew the guaranty and the lease is renewed. But what happens when the tenant fails to send the letter, or do whatever has to be done, in order to exercise its option to renew a lease?

The long standing rule, enunciated in J.N.A. Realty Corp. v Cross Bay Chelsea, 42 NY2d 392 (1977) had always been that if a commercial tenant had failed to timely exercise its option to renew the lease and that its failure was (1) inadvertent or an honest mistake, (2) the non renewal would result in a "forfeiture" by the tenant and (3) the landlord would not be prejudiced by the failure to timely renew, theories of equity would not force the tenant to lose its lease. A forfeiture results when a tenant made substantial improvements to the property in anticipation renewing the lease and the failure to remain in the space would result in a substantial loss to the tenant were it not allowed to renew its lease.

Recently the Court of Appeals had an opportunity to review this, and took the opportunity to clarifiy its meaning, resulting in a restrictive interpretation of its own guidelines. In Baygold Associates, Inc v Congregation Yetev Lev of Monsey, Inc., 19 NY3d 223 (2012) a dispute arose regarding whether the tenant properly notified the landlord of its intention to renew the lease, the landlord claimed that it was not notified that the tenant wanted to renew its lease, the tenant claimed it had sent a renewal letter pursuant to the terms of the lease. The trial court held a hearing to determine this issue. At the hearing, Baygold's lawyer testified that he had in fact mailed the letter. He was unable to produce a return receipt card, or any proof other than his billing paperwork to prove he had sent the letter. The trial court found that the lease was not renewed because Baygold was unable to establish the renewal notice was sent. The Supreme Court also refused to allow any equitable relief to Baygold because the attorney testified that he had in fact sent it and Baygold never alleged an excusable default such as an honest mistake or negligence in sending the renewal letter. The Appellate Division agreed with the determination that the renewal provision was not followed and also refused to renew the lease on equitable grounds. The Appellate court acknowledged the tenant has made over $1million in improvement in the first five years of the lease, but had made none over the next twenty years. The tenant, and subtenant in possession of the property, had gained the benefit of the improvements it had made and so was not subject to a forfeiture if the lease was not renewed.

The Court of Appeals affirmed the lower court's rulings. Baygold's subtenant was the tenant in possession, and had been since 1985 when Baygold made its last improvement. The court reasoned that since Baygold had profited from its sublease and would not suffer a 'substantial loss' if the lease was not renewed. The rule was designed to protect tenants in possession who make

improvements of a substantial character, not to protect the income stream of an out of possession tenant. Additionally, the court determined that improvements made over 20 years prior to the renewal at issue could not be made with a lease renewal in mind. Therefore, the majority ruled against Baygold, the tenant.

The dissent makes the point that the subtenant should not be punished for being the subtenant and not the tenant and that this 'arbitrary distinction' allows the landlord to benefit from the improvements the subtenant made in anticipation of the lease being renewed without any compensation to the subtenant.

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