



Equity intervenes to salvage a commercial tenant's untimely exercise of an option to renew

January 13, 2012 - Spotlights

The ever evolving concept of equity plays an important role in our judicial system. Equitable remedies are crafted by courts of equity to shield parties from harsh results that would otherwise prove unfair or unjust. Equity is frequently invoked in the commercial landlord-tenant arena, where strict contract construction can cause a tenant to lose its lease based solely upon mere inadvertence or a de minimis technicality. To avoid such results, equity will often intervene to avoid a tenant's forfeiture of its leasehold interests.

Just recently, in *135 East 57th Street LLC v. Daffy's Inc.*, equity intervened, by way of the Appellate Division, First Department, to protect a commercial tenant (Daffy's) from the "harsh result of strict contract construction" by excusing Daffy's untimely exercise of an option to renew its lease. In this case, Daffy's had operated a discount clothing store at 135 East 57th St. in New York City since November 7, 1994. Daffy's lease expired on January 31, 2011 and Daffy's had the option of two five year renewal terms, with the first term to be exercised in writing by January 31, 2010. Notwithstanding this definitive lease provision, Daffy's missed this deadline and did not attempt to exercise its lease renewal until February 4, 2010, or a few days after the deadline set forth in the lease. The landlord rejected the lease renewal and, two days later, commenced a lawsuit against Daffy's in New York County Supreme Court. The landlord sought a declaration (or judicial finding) that Daffy's failed to exercise its lease renewal in a timely fashion and that as a result thereof, its renewal option was terminated and its lease would expire on January 31, 2011. In its answer, Daffy's sought a declaration that it had effectively exercised its renewal option. After a three day bench trial, the lower court invoked its equitable powers and excused Daffy's belated exercise of its option to renew its lease. The landlord appealed to the Appellate Division, First Department.

On appeal, the appellate court affirmed the decision of the lower court. In doing so, the appellate court reiterated the well-accepted rule that when a contract requires written notice to be given within a specified time frame, the notice is deemed ineffective unless received within that prescribed time frame. The court, however, noted that an exception to this rule may be applied on equitable grounds. Specifically, courts in this jurisdiction have articulated a three-pronged test to determine when the late exercise of an option provision in a lease will be excused: (i) the tenant in good faith made substantial improvements to the premises and would otherwise suffer a forfeiture; (ii) the tenant's delay in exercising the option was the result of an excusable default; and (iii) the landlord was not prejudiced by the delay. Here, the appellate court readily ascertained that the second and third prong of the test had been met, since the four day delay in providing the one year's notice required by the lease did not prejudice the landlord, and the tenant had a reasonable and credible excuse for its default (a calendar error).

The appellate court, however, grappled with the issue as to whether equitable relief was appropriate

where the record failed to establish that Daffy's had made substantial alterations to the space. The court shifted its focus from the issue of alterations, and instead considered the goodwill that Daffy's had generated at the premises over the years. The record demonstrated that Daffy's had engendered sufficient goodwill in the approximately fifteen years that it had occupied its space. The court determined that Daffy's goodwill was an asset that would be damaged by its ouster from the premises, and mandated that equity intervene to avoid lease forfeiture by deeming the lease option properly exercised. In reaching this decision, the appellate court enlarged the tri-partite test used to excuse an untimely lease renewal by deeming the loss of goodwill a relevant factor in deciding whether or not to excuse a commercial tenant's belated exercise of a renewal option.

Thus, as illustrated by this case, equity may, under certain limited circumstances, intervene to protect a commercial tenant that has failed to timely or properly exercise an option to renew its lease. However, a tenant should not bank on the fact that equity will intervene on its behalf in the event it fails to properly exercise an option to renew, and must obviously make all efforts to comply with all time and notice provisions contained within its lease.

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