

CONSTRUCTION LAW

Renewal Option in a Commercial Lease: Failure Could Cost You Your Business

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It pays to be timely—especially in commercial tenancies. One common provision in commercial leases is an option requiring the tenant to notify the landlord of their intention to renew the lease or purchase the property by a specific date. What happens, however, if the tenant fails to provide the landlord with timely notice? State laws vary on this issue but, in New Jersey, courts generally enforce the lease as written. Therefore, if the tenant fails to renew by the deadline, courts will likely strictly enforce the lease terms. This is true even if the tenant has made a significant investment in the leased property. Although New Jersey courts have made exceptions to this general rule, these

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exceptions are only in certain narrow circumstances. This article explains the New Jersey laws that all landlords and tenants of commercial properties should know and compares New Jersey law to other jurisdictions.

General Rule: Strict Enforcement of the Option Provision

Generally, New Jersey courts enforce the lease as written and will not allow a tenant to renew after the deadline agreed to by the parties. As stated above, this is true even if the tenant has invested

a significant amount of money in the property or if the tenant's delay is based on an honest mistake. This approach comes out of the court's view that its role is to enforce contracts as written.

For example, in *Goldberg Corp. v. The Goldberg Realty & Investment Co.*, 134 N.J. Eq. 415, (Chan. 1944), the lease provided the tenant with an option to renew as long it provided notice a year and a half before the lease expired. When notice was due, the tenant informed the landlord that rather than exercising the option, it wanted

to execute a new lease. After failing to agree to terms, the landlord advised the tenant that another tenant was interested in the premises. The tenant attempted to renew after the landlord signed a lease with the new tenant but the landlord refused. The court denied the tenant's request to renew, highlighting the length of the tenant's delay, the timing of its notice, and the landlord's reliance on the tenant's decision not to renew.

Similarly, in *Kings Super Markets v. Stop & Shop Supermarket Co.*, 2006 WL 1449339 *4-5 (App. Div. May 26, 2006), the Appellate Division ruled that a tenant who was nine months late in providing notice to renew was not permitted to exercise its option, even though it invested roughly \$6 million in renovations on the property. The court held that to do so would ignore the terms of the lease for which the parties bargained.

Likewise, in *Brick Plaza v. Humble Oil*, 218 N.J. Super. 101 (App. Div. 1987), the tenant argued that its late notice was based on an unsigned draft of the lease that provided notice to be given five months before the lease expired. The executed lease, however, required that the tenant exercise its option three months before expiration. In rejecting the tenant's argument, the Appellate Division held that when an option is exercised long after the expired time period—in this case two and a half months—an honest

mistake of fact will not serve as an excuse.

Exceptions to the General Rule: When a Tenant's Late Notice Is Permitted

New Jersey courts permit a handful of narrow exceptions to the general rule of strict enforcement of the option provision. Specifically, in *Sosanie v. Pernetti Holding Corp.*, 115 N.J. Super 409 (Ch. Div. 1971), the Chancery Division held that a tenant's failure to give timely notice may be excused if the tenant can establish fraud, accident, surprise, mistake, or where there are other special circumstances warranting a court to grant a tenant relief.

In *Sosanie*, the tenant operated a luncheonette business on a leased premises for more than 10 years. After the tenant failed to timely exercise the option to renew, the landlord notified the tenant of its plan to use the premises for its own business. Within the same week, the tenant sent the landlord notice of its option to renew. The court ruled that the tenant was permitted to exercise its option even though it was untimely because the tenant established five special circumstances: (1) the tenant would sustain substantial harm if it were forced to relocate; (2) the landlord did not change its position in reliance on the tenant's delay; (3) the tenant's failure to give timely notice was due

to an honest mistake of fact; (4) the delay was slight; and (5) the loss to the landlord was insignificant. The relocation prong likely requires an inquiry into whether the success of the business relies on the location. For example, in *Sosanie* the neighborhood luncheonette tenant was permitted to remain on the premises while the court in *Kings*, a large supermarket chain, enforced the terms of the agreement.

NJ Law Regarding a Tenant's Premature Notice

New Jersey courts are more favorable to a tenant that has furnished a landlord at least some notice of their intent to renew prior to the date required in the lease. This exception likely stems from the fact the landlord had express knowledge of the tenant's intentions.

For example, in *Goodyear Tire & Rubber Co. v. Kin Properties*, 276 N.J. Super 96 (App. Div. 1994), the Appellate Division applied the special circumstances and equitable factors espoused in *Sosanie* when the tenant exercised its renewal option one year in advance of the period provided for in the lease. The Appellate Division held if the lease were not renewed, the tenant would suffer substantial hardship and that the landlord did not change its position in reliance of the early notice.

Similarly, in *Brunswick Hills Racquet Club v. Route 18 Shopping Ctr. Assocs.*, 182 N.J. 210 (2005),

the tenant gave the landlord notice of its intent to renew 19 months before the expiration date in the lease but mistakenly failed to comply with the payment portion of the option. The landlord failed to honor the option to renew, however, despite being aware that the tenant was making capital improvements to the premises in reliance that the option was renewed. The court ruled that the landlord breached its duty of good faith and fair dealing because it lulled the tenant into a false sense of security that it had exercised the option properly through a series of subterfuges, evasions and delays. Despite this ruling, tenants should be cautious in relying on the implied covenant to overcome the strict requirements of the lease unless some extraordinary circumstance exists.

Other Jurisdictions

It is important for commercial landlords and tenants to understand what state law controls a lease because laws differ on this issue. For example, New York courts have held that equity will relieve a tenant from a failure to timely exercise an option to renew or purchase if: (1) the tenant in good faith made substantial improvements to the premises and would otherwise suffer forfeiture; (2) the tenant's delay was the result of excusable default; and

(3) the landlord was not prejudiced by the delay. *See JNA Realty Corp. v. Cross Bay Chelsea*, 42 NY2d 392, 398 (1977). The test in New York appears to be more "tenant-friendly" than that in New Jersey, as it rewards a tenant for the improvements they made to the premises during the lease term to prevent an inequitable forfeiture. Notably, a New York court ruled that an honest mistake constituted excusable default and the loss of goodwill satisfied the forfeiture prong in allowing the tenant to renew its option. *See 135 East 57th Street v. Daffy's*, 2011 NY Slip Op. 08497.

Washington State also deems the commercial tenant's investment in the premises to be a key factor in deciding whether to permit a tenant to renew its option late. Another notable circumstance is the term of the lease, as the longer the term will strengthen the tenant's argument that strict compliance with the option notice should be supplanted. Alternatively, courts in Arizona, California, Ohio, Iowa and Utah have ruled that commercial tenants are only entitled to equitable relief if they can prove that the failure was caused by the landlord or the landlord waived the notice requirement.

Conclusion and Recommendations

Unless the delay is minimal, the landlord did not change its position

in reliance on the tenant's failure to notify, or the tenant was lulled into a false sense of security by the landlord after giving premature notice, New Jersey courts will likely enforce the lease as written because courts are reluctant to insert their own set of morals to govern the commercial marketplace.

Fortunately, both landlords and tenants can prevent these issues with their own attentive planning. For example, if a lease's notice requirement has elapsed, the landlord should immediately provide written notice to the tenant—even if not required by the lease—to eliminate any potential "wait and pounce" argument from the tenant. This may preserve the *Sosanie* factors. Landlords should also diligently document any negotiations with tenants to evidence their reliance on the tenant's failure to renew. Additionally, if the tenant has given its notice prematurely and not within the time period expressed in the provision, the landlord should, as a precautionary measure, remind the tenant of the time when the notice is due. Conversely, a tenant could seek to include a requirement in the option provision where the landlord notify them before the renewal period closes. If you have further questions about the laws on this issue, you should contact your trusted counsel. ■