

# Real Estate Leases - Options to Renew, Extend, or Purchase

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## COMMENTS

### REAL ESTATE LEASES—OPTIONS TO RENEW, EXTEND, OR PURCHASE

#### INTRODUCTION

Real estate leases, containing options to renew, or extend the term, or to purchase the premises often pose many vexing problems. It is the purpose of the writer to consider a few of these problems. The subtopics each treat a different aspect of the subject, and are related only in that the problems presented therein arise in connection with options.

#### FIRST RIGHT OR FIRST PRIVILEGE TO RENEW

The numerical majority of courts as well as of cases indicate that the option, right, or privilege is conditional and rests upon the willingness of the lessor to lease the property again at the term expiration rather than to sell it, to use it himself, to demolish buildings thereon, or otherwise to use it in some manner inconsistent with a leasing of it.<sup>1</sup>

In a Massachusetts case, the lessee was given "the first right to re-lease for a term of three more years at the expiration of the present lease, on the same conditions and terms."<sup>2</sup> In holding that no absolute and unqualified right to a renewal arose from these words, the court said the word *first* should not be rejected as surplusage, but rather should be interpreted as granting a preferential right to have a release at the option of the lessee in the event the lessor at that time should desire to lease the property.<sup>3</sup> While the words contained in the leases vary somewhat in each case, this has been the general construction given to such clauses when they have been the cause of litigation.<sup>4</sup>

There is, however, authority that such words create an absolute or unconditional right in the lessee to secure a new term. Called upon to construe a "first privilege" of releasing, a Pennsylvania court said:

We feel that the words first privilege in this connection should not be so construed as to nullify a valuable right in the hands of the lessee which . . . was

<sup>1</sup> Granting to Lessee of "First" Privilege or Right to Re-Lease or to Renewal or Extension of Tenancy Period as Conditioned upon Lessor's Willingness to Re-Lease, 6 A.L.R. 2d 820 (1949).

<sup>2</sup> Cloverdale Co. v. Littlefield, 240 Mass. 129, 133 N.E. 565 (1921).

<sup>3</sup> Ibid.

<sup>4</sup> Laevin v. St. Vincent De Paul Soc. of Grand Rapids, 323 Mich. 607, 36 N.W. 2d 163 (1949); Buddenberg v. Welch, 97 Ind. App. 87, 185 N.E. 865 (1933); Fergen v. Lyons, 162 Wis. 131, 155 N.W. 935 (1916); Pearce v. Turner, 150 Ill. 116, 36 N.E. 962 (1894).

evidently intended to be created. It was of no possible use to make provision merely that one party should enjoy a certain right, if the other party should consent thereto.<sup>5</sup>

#### FIRST PRIVILEGE TO PURCHASE

A provision in a lease of real property, granting to the lessee the "first" right, privilege, or option to purchase the leased premises, or a substantially similar provision, has generally been construed as conferring a merely conditional option, dependent upon the lessor's subsequent decision or offer to sell.<sup>6</sup>

In a recent Pennsylvania decision, the clause in question was, "[I]t is also agreed that the lessee shall have first option on buying the property at six thousand dollars." In holding the option conditional on the lessor's desire to sell, the court did not find that the statement of the price made the option absolute.<sup>7</sup>

While in most cases the finding of the option to be conditional was based upon a consideration of the option clause alone, many courts have arrived at the same conclusion only after considering the lease as a whole and the extrinsic circumstances.<sup>8</sup>

Some courts have held the words "first privilege" to confer an absolute right to purchase. In so doing, the word "first" has been explained away as not being of controlling significance, when considered in the light of the entire instrument.<sup>9</sup>

#### HOLDING OVER AS SUFFICIENT TO EXERCISE OPTION TO EXTEND OR RENEW

Practically all courts agree that a provision for *extension* as distinguished from a provision for *renewal* does not contemplate the execution of a new lease contract; under such a provision mere holding over by the lessee and continued payment of rent will suffice to continue the relation-

<sup>5</sup> *Stetler v. North Branch Transit Co.*, 258 Pa. 299, 301, 101 Atl. 980, 981 (1917). Accord: *McDonald v. Karpeles*, 61 Pa. Super. 496 (1915); *Butt v. Maier & Zobelein Brewery*, 6 Cal. App. 581, 92 Pac. 652 (1907).

<sup>6</sup> *Wilson v. Singleton*, 410 Ill. 611, 103 N.E. 2d 72 (1951); *Falkenstein v. Popper*, 81 Cal. App. 2d 131, 183 P. 2d 707 (1947); *Nu-Way Serv. Stations v. Vandenberg Bros. Oil Co.*, 283 Mich. 551, 278 N.W. 683 (1938); *Sander v. Schwab*, 315 Ill. 623, 146 N.E. 509 (1925); *Hayes v. O'Brien*, 149 Ill. 403, 37 N.E. 73 (1894).

<sup>7</sup> *Reichman v. Fisher*, 60 Pa. D. & C. 673 (1947). Accord: *R. I. Realty Co. v. Terrell*, 254 N.Y. 121, 172 N.E. 262 (1930).

<sup>8</sup> *Stein v. Reising*, 359 Mo. 804, 224 S.W. 2d 80 (1949); *Hake v. Groff*, 232 Mich. 233, 205 N.W. 145 (1925).

<sup>9</sup> *Langer v. Stegerwald Lumber Co.*, 259 Wis. 189, 47 N.W. 2d 734 (1951), rehearing denied 262 Wis. 383, 55 N.W. 2d 389 (1952), rehearing denied 56 N.W. 2d 512 (1953); *Tantum v. Keller*, 95 N.J. Eq. 466, 123 Atl. 299, aff'd 96 N.J. Eq. 672, 126 Atl. 925 (Ct. Error & App., 1924); *Barnhart v. Stern*, 182 Wis. 197, 196 N.W. 245 (1923).

ship of landlord and tenant for the full period of the extended term stipulated for in the absence of indications of a contrary intention.<sup>10</sup> But where the lease gives the privilege of a renewal, there is a split of authority. Some courts say the tenant, by some affirmative act, must indicate his election to avail himself of that privilege prior to the expiration of the current term.<sup>11</sup> According to the other view, mere holding over is sufficient to render the lessee liable, on the one hand, for the full additional time, and on the other hand is sufficient to give him full right to possession for that period.<sup>12</sup>

*Wanous v. Balaco*<sup>13</sup> presented a situation where a lease contained an option to purchase. The lessee held over, paid rent, and became a tenant from year to year. While holding over, the lessee attempted to exercise the purchase option. In refusing to compel a conveyance the court was of the opinion that the option to purchase was not such a provision as would be incorporated in a year to year tenancy created by operation of law.

#### WHAT CONSTITUTES NOTICE

Where the lease is silent as to the type of notice to be given the lessor, the lessee must show that he gave a proper notice or made a proper request for renewal of the lease in a binding manner.<sup>14</sup>

It is quite generally recognized that where a lessee has a right of renewal provided he gives the lessor notice by a specified time that he intends to exercise such privilege, the giving of the notice is a condition precedent which must be complied with within the stipulated time, and that in the absence of special circumstances warranting a court of equity in granting relief, the right of renewal is lost if the notice is not given in accordance with the provisions of the lease.<sup>15</sup> It is apparently unnecessary

<sup>10</sup> *Straus v. Shaheen, Inc.*, 310 Mass. 646, 39 N.E. 2d 573 (1942); *Gordon v. Tennant*, 108 Ind. App. 326, 26 N.E. 2d 559 (1940); *Blanck v. Kimland Realty Co.*, 122 Conn. 317, 189 Atl. 176 (1937); *Anderson v. Dodsworth*, 292 Ill. 335, 127 N.E. 43 (1920).

<sup>11</sup> *Johnson v. Mary Oliver Candy Shops, Inc.*, 116 Conn. 86, 163 Atl. 606 (1933); *Linden Park Garage, Inc. v. Capitol Laundry Co.*, 284 Mass. 454, 187 N.E. 849 (1933); *Vincent v. Laurent*, 165 Ill. App. 397 (1911); *Thiebaud v. First Nat'l Bank of Vevay*, 42 Ind. 212 (1873).

<sup>12</sup> *Sloan v. Longcope*, 288 Pa. 196, 135 Atl. 717 (1927); *Stout v. Tobias*, 27 Ohio App. 113, 160 N.E. 874 (1927); *Straus v. Robbin*, 4 N.J. Misc. 631, 133 Atl. 868 (S. Ct., 1926); *Metzgar Register Co. v. Thomas Canning Co.*, 220 Mich. 435, 190 N.W. 245 (1922).

<sup>13</sup> 412 Ill. 545, 107 N.E. 2d 791 (1952).

<sup>14</sup> *Gaggiano v. Gralloranzi*, 26 Misc. 819, 57 N.Y.S. 2 (S. Ct., 1899).

<sup>15</sup> *Bickford v. Dillon*, 321 Mass. 82, 71 N.E. 2d 611 (1947); *Fuchs v. Peterson*, 315 Ill. 370, 146 N.E. 556 (1925); *Donovan Motor Car Co. v. Niles*, 246 Mass. 106, 140 N.E. 304 (1923); *Beller v. Robinson*, 50 Mich. 264, 15 N.W. 448 (1883); *Thiebaud v. First Nat'l Bank of Vevay*, 42 Ind. 212 (1873).

for the notice of renewal to embrace the terms of the renewal lease, unless such is the necessary implication of the original lease.<sup>16</sup>

The decisions are in general agreement that where no method of notice is specified, the notice need not be in writing, but may be oral.<sup>17</sup> The reasoning upon which these decisions are based is that the lessee holds the premises for the extension or renewal term under the original lease, and not by virtue of the notice, and hence the writing of the lease satisfies the Statute of Frauds.<sup>18</sup>

Many leases which contain options to extend or renew provide that notice shall be in writing and served upon the lessor within a specified time. Such provisions are generally construed to mean that mailing is permitted, and the option is properly exercised if deposited in the mails on or before the date due.<sup>19</sup> An interesting situation was presented in *Giordano v. Zap*,<sup>20</sup> where the lease provided for notice of exercise of the option to be given ninety days prior to expiration of the term. The court construed this to mean personal notice. The lessee mailed his notice within the ninety day period, but the lessor was out of the country one hundred thirty-five days prior to the end of the term. In holding the option properly exercised, the court said that the lessor could not have anticipated that the lessee must discover the whereabouts of the lessor in Italy in order to give him personal notice.

A recent Illinois case involved a lease which contained both an option to renew and an option to purchase. The option to renew was admittedly properly exercised. The court held that when the lease was renewed, all provisions thereof, including the purchase option, were renewed. Therefore, the purchase option continued during the renewal period.<sup>21</sup> In *Kleros Bldg. Corp. v. Battaglia*,<sup>22</sup> there were two lessees. The lease provided, "[l]essee(s) shall have option to renew this lease . . . provided they serve notice . . . on lessor,"<sup>23</sup> and one of the lessees served notice. The court held one of the lessees alone could not exercise the option.

<sup>16</sup> *Darling Shop of Birmingham, Inc. v. Nelson Realty Co.*, 262 Ala. 495, 79 So. 2d 792 (1954); *Denny v. Jacobson*, 243 Iowa 1383, 55 N.W. 2d 568 (1952); *Stern Co. v. Friedman*, 229 Mich. 623, 201 N.W. 961 (1925); *Whitcomb v. Indianapolis Traction & Terminal Co.*, 64 Ind. App. 605, 116 N.E. 444 (1917).

<sup>17</sup> *Dickinson v. Robinson*, 272 Fed. 77 (C.A. 4th, 1921); *Darling v. Hoban*, 53 Mich. 599, 19 N.W. 545 (1884).

<sup>18</sup> *Ibid.*

<sup>19</sup> *James v. Hutchinson*, 211 S.W. 2d 507 (1948); *Gorman v. General Outdoor Advertising Co.*, 320 Ill. App. 339, 50 N.E. 2d 854 (1943); *Baxter Laundries, Inc. v. Lucas*, 43 Ohio App. 518, 183 N.E. 538 (1932); *Case v. Fagin*, 221 Ill. App. 209 (1921).

<sup>20</sup> 115 Misc. 619, 189 N.Y.S. 88 (S. Ct., 1921).

<sup>21</sup> *Hindu Incense Mfg. Co. v. MacKenzie*, 403 Ill. 390, 86 N.E. 2d 214 (1949).

<sup>22</sup> 348 Ill. App. 445, 109 N.E. 2d 221 (1952).

<sup>23</sup> *Ibid.*

An option to purchase was contained in the lease in *Welsh v. Jakstas*.<sup>24</sup> The price was contained in the option and the lessee served notice of his exercise on the lessor. Although some details were left to future agreement, the lessor had an attorney draw a proposed sales contract and the parties met to draft a contract. The court held that the conduct of the lessor was consistent with an acceptance of the terms, and the option was properly exercised.

#### DOCTRINE OF RELATION BACK

When the tenant exercises his option to purchase the property, it is said that the relation of landlord and tenant ends and the relation of vendor and purchaser is created. The lessor may not thereafter avoid his duty to convey by declaring a forfeiture of the lease<sup>25</sup> and the lessee is no longer liable for rent.<sup>26</sup> In some cases the courts have applied the doctrine of equitable conversion and held that the conversion relates back to the date when the option was given, normally the date of the lease. So it has been held that the lessee is entitled to an award made upon partial condemnation of the property<sup>27</sup> and to insurance proceeds from a partial destruction of a building on the premises,<sup>28</sup> the event in each case occurring during the term but prior to the exercise of the option. The English courts have applied this relation back rule in determining who is entitled to the proceeds in the event the lessor *dies* after the execution of the lease *and before the option is exercised*. A few states have followed the English rule. The majority of American jurisdictions, however, refusing to apply the fiction of relation back in this situation, give the proceeds to the lessor's heirs or devisees, rather than to next of kin or legatees.<sup>29</sup>

The courts generally agree that when the optionee dies before the option is exercised, there is no relation back.<sup>30</sup> Therefore, when one of the parties to the lease dies, the equitable conversion takes place at the date of the exercise of the option and not at the date of the lease.<sup>31</sup>

<sup>24</sup> 401 Ill. 288, 82 N.E. 2d 53 (1948).

<sup>25</sup> *Jader v. Costello*, 405 Ill. 181, 89 N.E. 2d 814 (1950).

<sup>26</sup> *Moore v. Maes*, 214 S.C. 274, 52 S.E. 2d 204 (1949).

<sup>27</sup> *Cullen & Vaughn Co. v. Bender Co.*, 122 Ohio St. 82, 170 N.E. 633 (1930).

<sup>28</sup> *Schnee v. Elston*, 299 Pa. 100, 149 Atl. 108 (1930).

<sup>29</sup> *Durepo v. May*, 73 R.I. 71, 54 A. 2d 15 (1947); *Ingraham v. Chandler*, 179 Iowa 304, 161 N.W. 434 (1917); *Smith v. Loewenstein*, 50 Ohio St. 346, 34 N.E. 159 (1893).

<sup>30</sup> *Thommen v. Smith*, 88 N.J. Eq. 476, 103 Atl. 25 (1918); *Gustin v. Union School Dist.*, 94 Mich. 502, 54 N.W. 156 (1893); *Sutherland v. Parkins*, 75 Ill. 338 (1874).

<sup>31</sup> *In re Bisbee's Estate*, 177 Wis. 77, 187 N.W. 653 (1922); *Adams v. Peabody Coal Co.*, 230 Ill. 469, 82 N.E. 645 (1907); *Smith v. Loewenstein*, 50 Ohio St. 346, 34 N.E. 159 (1893).

## OPTION TO PURCHASE-ASSIGNMENT

It is generally agreed that, absent a manifestly contrary intention of the parties, upon a valid assignment of a lease containing an option to purchase, the option, as a covenant running with the land, passes to the assignee and may be enforced by him in the same manner and to the same extent as by the original lessee.<sup>32</sup> But where the option clause provides for the extension of credit to the optionee for at least a portion of the purchase price, upon acceptance of the option, the option contemplates a relation of personal confidence between the lessor and the lessee and it is therefore not assignable.<sup>33</sup> However, in *Rosello v. Hayden*,<sup>34</sup> a lease contained an option to purchase partly on credit and the court held that the assignee of the lease could enforce the option upon offering to pay cash in full.

## CONCLUSION

It can be seen that in dealing with option clauses contained in real estate leases, the courts apply rules of law only after considering (1) the language of the option clause, (2) the lease in its entirety, (3) the intention of the parties and (4) the extrinsic circumstances in each case.

Many of the problems which arise would be avoided or more easily solved by more careful draftsmanship in order to manifest the intent of the parties.

<sup>32</sup> *In re Frayser's Estate*, 401 Ill. 364, 82 N.E. 2d 633 (1948); *Keogh v. Peck*, 316 Ill. 318, 147 N.E. 266 (1925).

<sup>33</sup> *Kritz v. Moon*, 88 Ind. App. 5, 163 N.E. 112 (1928); *Prichard v. Kimball*, 190 Cal. 757, 214 Pac. 863 (1923); *Menger v. Ward*, 87 Tex. 622, 30 S.W. 853 (1895).

<sup>34</sup> 79 So. 2d 682 (Fla., 1955).

CHARITIES—RECENT DEVELOPMENTS  
IN ILLINOIS, 1942–1957

Increasing interest has been focused on the law of charitable trusts. Perhaps the most notable development has been in the field of tort immunity.<sup>1</sup> In view of the immense public value of charities, problems such as "what qualifies as a charity"<sup>2</sup> and "how can charities be saved from invalidity" are of great significance. Of course tax considerations which pervade all fields of law are also a problem in charitable trusts. The following discussion does not attempt to develop any particular aspect of charities but rather to review the Illinois cases from 1942 to 1957.

<sup>1</sup> *Charitable Institutions—Immunity from Tort Liability*, 4 De Paul L. Rev. 56 (1954).

<sup>2</sup> Professor Curran has discussed the question of whether a trust for masses qualifies as a valid charity. Curran, *Trust for Masses*, 7 Notre Dame Lawyer 42 (1931); and Curran, *Charitable Trusts for Masses 1931–1956*, 5 De Paul L. Rev. 246 (1956).