Equitable Relief Under 'J.N.A. Realty Corp.'

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It is now almost 35 years since the Court of Appeals issued its landmark decision in *J.N.A. Realty Corp. v. Cross Bay Chelsea*.[1] In *J.N.A.*, the state's high court held that equity will intervene to relieve a tenant who fails to timely exercise a renewal option in a lease, where the tenant's failure to timely exercise the option is due to "excusable default" and the tenant would suffer a forfeiture if the lease was not renewed.

Just last month, the Court of Appeals had the opportunity to revisit *J.N.A.* in *Baygold Associates, Inc. v. Congregation Yetev Lev of Monsey*, __ N.E..2d __ , 2012 N.Y. Slip. Op. 03472 (May 3, 2012). In *Baygold*, the Court of Appeals was presented with the issue of whether an out-of-possession tenant, which had made its own improvements to the leased premises, was entitled to equitable relief under *J.N.A.* to relieve the tenant from its inadvertent failure to timely exercise its renewal option. The Court of Appeals held that relief under *J.N.A.* was not available in these circumstances.

'J.N.A. Realty Corp.'

In *J.N.A.*, the subject lease was for a 10-year term expiring on Jan. 1, 1974. The lease granted the tenant, Cross Bay Chelsea, Inc., an option to renew the lease for an additional 24 years, provided that the tenant notify the landlord in writing of the exercise of the option six months prior to the last day of the lease term. Thus, pursuant to the lease, the tenant was required to notify the landlord of the exercise of the renewal option no later than July 1, 1973.[2]

The tenant, due to its own negligence, failed to notify the landlord of its intention to exercise the renewal option until Nov. 16, 1973, more than four months after the deadline in the lease. The landlord refused to honor the tenant's notice as untimely, and the tenant sought to be relieved of its default on equitable grounds.[3] The Court of Appeals ruled in the tenant's favor, stating:

But when a tenant in possession under an existing lease has neglected to exercise an option to renew, he might suffer a forfeiture if he has made valuable improvements on the property.

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More recently it has been noted that 'although the tenant has no legal interest in the renewal period until the required notice is given, yet an equitable interest is recognized and protected against forfeiture in some cases where the tenant has in good faith made improvements of a substantial character intending to renew the lease, if the landlord is not harmed by the delay in the giving of the notice and the lessee would sustain substantial loss in case the lease were not renewed' (citations omitted).[4]

The court found that the tenant in *J.N.A.* would suffer a forfeiture if equity did not intervene in that:

the tenant has made a considerable investment in improvements on the premises—$40,000 at the time of purchase, and an additional $15,000 during the tenancy. In addition, if the location is lost, the restaurant would undoubtedly lose a considerable amount of its customer good will…. Thus, under the circumstances of this case, the tenant would be entitled to equitable relief if there is no prejudice to the landlord.[5]

In recent years, courts have summarized the *J.N.A.* criteria for the granting of equitable relief as follows:

Equity will relieve a tenant from a failure to timely exercise an option in a lease to renew or purchase if (1) the tenant in good faith made substantial improvements to the premises and would otherwise suffer a forfeiture, (2) the tenant's delay was the result of an excusable default, and (3) the landlord was not prejudiced by the delay (citations omitted).[6]

'Baygold'

The facts as recited by the Court of Appeals in *Baygold* are as follows: The tenant, Baygold Associates, Inc. (Baygold), entered into the subject lease on Aug. 2, 1976 with the owner and landlord of the premises, Monsey Park Hotel (MPH), for a 10-year term. The lease gave the tenant the option to renew the lease term for four additional 10-year periods, provided that the tenant gave written notice to the landlord no later than 270 days prior to the expiration of each term or extended term. Baygold thereafter subleased the premises, with MPH's consent, to its affiliate, Monsey Park Home for Adults (Monsey Park). Monsey Park operated the premises as a nursing home from 1976 through 1985. During its occupancy, Monsey Park made approximately $1 million in improvements to the premises, including capital improvements to the roof, driveways and boiler.

In 1985, Monsey Park, with MPH's permission, sub-subleased the premises to Israel Orzel, who continued to operate the premises as a nursing home. During the period of Orzel's tenancy, only Orzel made improvements to the premises. In addition, Orzel paid Baygold approximately $200,000 in annual rent due under the sub-sublease for the first 10 years, and $240,000 annually during the second 10-year term.

In July 2007, the Rubenfelds, as successors to MPH—which had entered into a contract to sell the property—notified Baygold's counsel that the lease was to expire on Sept. 30, 2007. In response, Baygold's counsel provided the Rubenfelds with a copy of a letter dated Nov. 1, 2005 purporting to exercise the renewal option. Baygold's counsel, however, was unable to produce either a certified mail receipt or return receipt card. Thus, the Rubenfelds refused to honor Baygold's purported exercise of the renewal option.

Baygold commenced an action against MPH seeking a declaration "concerning the actual termination of the Lease." The Supreme Court, after a bench trial, held that the lease had not properly been renewed because Baygold failed to establish that notice was sent in compliance with the lease. The court also denied Baygold's request for equitable relief under *J.N.A.*, finding that the failure to renew the lease was not the result of an "excusable default" because Baygold's counsel did not allege any mistake, but rather testified that he actually complied with the lease.

The Appellate Division, Second Department affirmed. Among other things, the Appellate Division held that Baygold was not entitled to equitable relief under *J.N.A.* because Baygold failed to demonstrate "that it 'made improvements of a substantial character in anticipation of renewing the lease.'"[7]

The Court of Appeals affirmed, in a 4-2 decision signed by Judge Eugene Pigott, with Chief Judge Jonathan Lippman, and Judges Carmen Ciparick and Susan Read concurring. Judge Robert Smith dissented, with Judge Victoria Graffeo concurring.

The Court of Appeals assumed, for purposes of the appeal, that Baygold's failure to comply with the lease renewal provision was the result of an excusable default. Thus, the only issue was whether "non-renewal would result in a forfeiture by Baygold."

The Court of Appeals reaffirmed its pronouncement in *J.N.A.* that "a forfeiture results where the tenant 'has in good faith made improvements of a substantial character, intending to renew the lease' and the tenant 'would sustain a substantial loss if the lease were not renewed.'" In addition, citing to its 1971 ruling in *Sy Jack Realty Co. v. Pergament Syosset Corp.*,[8] the court stated that "the 'long-standing location for a retail business is an important part of the good will of that enterprise' and that a tenant may be entitled to equitable relief through the loss of such 'a substantial and valuable asset.'"

The Court of Appeals held that Baygold had failed to establish that it would suffer a forfeiture. The court rejected Baygold's reliance on its affiliate having made "$1 million in improvements between 1972 and 1985 with the expectation that it would derive revenue from possessing a 50-year lease," stating that:

Unlike the tenant in *J.N.A. Realty*, however, neither Baygold nor any of its affiliates was a tenant in possession of the premises at the time of the failure to comply with the lease renewal provision. Nor can it be said that Baygold, having profited from its sublease with Orzel since 1985 while having expended no monies on improvements, would incur a 'substantial loss' should the lease not be renewed, as Baygold has undoubtedly 'reaped the benefit of any initial expenditure' [citation omitted]. The forfeiture rule was crafted to protect tenants in possession who make improvements of a 'substantial character' with an eye toward renewing a lease, not to protect the revenue stream of an out-of-possession tenant like Baygold.

The Court of Appeals further found that the improvements that Baygold had itself made to the premises over 20 years earlier, when it was a tenant-in-possession, could not be said to have been made "with a view toward renewal of the lease." The court found that such improvements were "too attenuated from Baygold's failure to exercise the option over 20 years later."

The Court of Appeals also rejected Baygold's attempt to rely on the improvements that the sub-subtenant, Orzel, had made to the premises to support Baygold's claim of forfeiture:

our holding in *J.N.A. Realty* is restricted to tenants who make 'considerable investment in improvements' to the premises in anticipation of the lease renewal or would 'lose a considerable amount of customer good will' should the lease not be renewed. [citation omitted]. This narrow equitable doctrine was never intended to apply in a circumstance like this, where the out-of-possession tenant fails to make any improvements in anticipation of renewal and does not possess any good will in a going concern.

Finally, the court rejected Baygold's claim that it was "entitled to equitable relief because it incurred litigation expenses to cure alleged defaults on the part of Orzel, who allegedly entered into an illegal sub-sub-tenancy." The court found that such expenses "do not constitute 'substantial improvements' to the premises."

Smith, in his dissenting opinion, stated that the majority seemed to have made "an arbitrary distinction between tenants and subtenants" in applying the rule of *J.N.A.*

Smith stated that although the subtenant, and not the tenant, had made the improvements, the result of the tenant's inadvertence in failing to exercise the renewal option "is no less a forfeiture." Smith explained:

Because the tenant failed to send a certified mail notice by the prescribed date, the subtenant loses improvements that cost, according to evidence in the record, several hundred thousand dollars; the tenant loses the revenue it anticipated from the sublease; and the landlord gets the improvements for nothing. The only distinction between this case and *J.N.A.* is that the subtenant, not the tenant, was the party 'in possession' and the party that paid for the improvements. Why that should make a difference is a question that the majority opinion makes no attempt to answer.

Conclusion

The Court of Appeals has now held that the right to equitable relief under *J.N.A.* does not apply to an "out of-possession tenant" that has not made improvements of its own to the leased premises. The question arises, however, whether an out-of-possession tenant that has paid for improvements to the demised premises might be entitled to relief under *J.N.A.* The answer to that question must await a future determination.

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Endnotes:

1. 42 N.Y.2d 392, 397 N.Y.S.2d 958 (1977).

2. 42 N.Y.2d at 395.

3. Id. at 396.

4. Id. at 397-98.

5. Id. at 399-400.

6. *Vitarelli v. Excel Automotive Tech. Center*, 25 A.D.3d 691, 811 N.Y.S.2d 689 (2d Dept. 2006).

7. 81 A.D.3d 763, 765, 916 N.Y.S.2d 639 (2d Dept. 2011).

8. 27 N.Y.2d 449, 453, 318 N.Y.S.2d 720 (1971).
