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# Applying Rule, Court Voids Lease Renewal Option Clause

Warren A. Estis and William J. Robbins, partners at Rosenberg & Estis, analyze *Bleecker Street Tenants Corp. v. Bleeker Jones LLC*, where the Appellate Division, First Department, addressed the issue of whether the Rule against Perpetuities voided the renewal options clause in the parties' lease or whether the exception to that rule for options appurtenant to a lease was applicable.

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A recent decision by the Appellate Division, First Department in [Bleecker Street Tenants Corp. v. Bleeker Jones LLC](#)<sup>1</sup> addressed the issue of whether the Rule against Perpetuities voided the renewal options clause in the parties' lease or whether the exception to that rule for options appurtenant to a lease was applicable. The Appellate Division decision was written by Justice David B. Saxe, with all the other judges on the panel, i.e., Presiding Judge Luis A. Gonzalez, Justice Angela M. Mazzarelli, Justice Karla Moskowitz and Justice Rosalyn H. Richter concurring. We discuss here the court's reasoning and the case authority on which it relied.

In *Bleecker Street*, the plaintiff was the owner of a six-story walk-up that had been converted to cooperative ownership in 1983. Contemporaneously with that conversion, the building's first-floor commercial space was leased to defendant Bleeker Jones LLC's predecessor in interest, which was a partnership made up of the same four individuals who made up the sponsor partnership.

The lease provided for an initial term of 14 years, with nine options to renew for consecutive 10-year periods. The renewal options could be exercised together or successively. Per the lease, the method for exercising the renewal options was by giving written notice to the landlord at least six months prior to the expiration date of the immediately preceding term of the lease.

The lease further provided as follows:

...[I]n the event Lessee has not heretofore timely exercised any renewal option and provided Lessor has not notified Lessee of the existence of such option within seven (7) calendar months prior to the date on which each term ends [the '7-months' notice'], then each such renewal option shall continue to remain in effect and Lessee may exercise such renewal option within sixty (60) days after Lessor notified Lessee in writing of its right to exercise each such option, notwithstanding the fact that the term of said lease may have expired. If the term shall have expired, Lessee shall remain in possession as a month-to-month tenant until Lessor shall have complied with the foregoing.<sup>2</sup>

At the end of the initial 14-year lease term, on Aug. 30, 1997, the renewal option went unexercised. Apparently, too, the landlord never gave the seven-month notice nor did it send a 60-day notice. Accordingly, the commercial tenant remained in possession as a month-to-month tenant.

In December 2007, the owner commenced the lawsuit, seeking, as summarized by the Appellate Division, "a declaration

that the lease renewal options are void under the statutory and common-law rules against perpetuities and unreasonable restraints on alienation." The owner sued both the current tenant and its predecessor in interest that had initially signed the lease. The defendants moved, and the plaintiffs cross-moved, for summary judgment.

The Supreme Court (Carol R. Edmead, J.) granted the defendants' motion for summary judgment. The Appellate Division reversed, granting plaintiff's cross-motion to the extent of declaring that (1) the renewal options clause of the lease was void as violating the rule against remote vesting contained in section 9-1.1(b) of the Estates, Powers and Trusts Law ("EPTL"), and (2) the current tenant and its predecessor in interest, and their subtenants and/or assignees, are month-to-month tenants. The Appellate Division rejected plaintiff's claim to the extent it was predicated on EPTL 9-1.1(a) and the common law rule against unreasonable restraint on alienation.

In *Metropolitan Transportation Authority v. Bruken Realty Corp.*,<sup>3</sup> one of the cases cited by the Appellate Division in *Bleecker Street*, the Court of Appeals concisely summarized the above-referenced statutory and common law rules as follows:

In New York an owner's power to dispose of property is limited by three rules. The first two, known as the Rule Against Perpetuities, are found in subdivisions (a) and (b) of EPTL 9-1.1. The Rule declares that no estate in property shall be valid (1) if the instrument conveying it suspends the power of alienation for a period longer than lives in being at the creation of the estate plus 21 years and (2) unless it must vest, if at all, before expiration of the same period. ...The third rule regulating dispositions is established by common law and invalidates conveyances which impose unreasonable restraints on alienation.<sup>4</sup>

The Court of Appeals in *Metropolitan Transportation Authority* further explained that when the parties to an agreement are corporations, and no measuring life or lives are stated in the instruments, "the permissible period is 21 years."

The Appellate Division in *Bleecker Street* began its analysis by quoting EPTL 9-1.1(b), which provides in relevant part that:

No estate in property shall be valid unless it must vest, if at all, not later than twenty-one years after one or more lives in being at the creation of the estate...

Citing *Metropolitan Transportation Authority*, as well as another Court of Appeals decision, *Symphony Space Inc. v. Pergola Properties Inc.*,<sup>5</sup> the court explained that "the perpetuities period is simply 21 years" because the parties to the lease were corporate entities and no measuring lives were stated in the lease.

The Appellate Division briefly explained the purpose of the Rule against Perpetuities, relying on those same two Court of Appeals decisions. The rule is based on the principle that "it is socially undesirable for property to be inalienable for an unreasonable period of time." Its purpose is "to ensure the productive use and development of property by its current beneficial owners by simplifying ownership, facilitating exchange and freeing property from unknown and embarrassing impediments to alienability."

Since all of the renewal options except the first in *Bleecker Street* vest more than 21 years after execution of the lease, on their face they run afoul of the Rule against Perpetuities. However, as the court stated, "an exception to the rule's generally strict application exists for options appurtenant to a lease, which are considered 'part of the lease.'" Citing *Symphony Space*, the court specified the following as necessary characteristics of such appurtenant options: they originate in one of the lease provisions, are not exercisable after lease expiration and are incapable of separation from the lease.

The Appellate Division cited its 2009 decision in *Double C Realty Corp. v. Craps, LLC*<sup>6</sup> as an example of a lease renewal option to which the "appurtenant option" exception was found applicable, so that renewal options were held valid even though the holder's interest might vest beyond the 21-year perpetuities period. In contrast to *Double C Realty*, the Appellate Division cited another case it had decided, in 1994, *Warren Street Associates v. City Hall Tower Corp.*,<sup>7</sup> where that exception was held inapplicable.

In *Warren Street Associates*, the lease provided for a 50-year term with six 25-year options after the original term, to be exercised by the tenant by notifying the landlord at least three months before the expiration of the term then in effect. However, the renewal options clause included the following proviso:

...a failure by Tenant to serve any such notice [exercising the renewal option] shall not extinguish the renewal option to which same would have related, and such renewal option will only be considered extinguished and not exercised after Landlord notifies Tenant that Tenant has not so exercised same and Tenant, within 40 days after receipt of such notice,

still does not serve a notice exercising such option. If Tenant serves a renewal notice, the term hereof shall be deemed automatically renewed and extended.<sup>8</sup>

In *Warren Street Associates*, the Appellate Division concluded that the lease thereby allowed the renewal option to exist, and be exercised, even after the lease term expired as a result of the tenant's failure to serve a renewal notice before expiration of the lease term. Thus, the requirement for the "appurtenant to the lease" exception that the option not be exercisable after lease expiration was not satisfied, making that exception inapplicable.

The Appellate Division also considered a Supreme Court, New York County (Herman Cahn, J.) decision in *Deer Cross Shopping LLC v. Stop & Shop Supermarket Company*.<sup>9</sup> In that case, too, the issue was whether the "appurtenant to the lease" exception was applicable. There, the original lease term was for 25 years, with the tenant having options to extend the lease for three additional 10-year terms.

The lease there contained a provision similar to the lease in *Bleecker Street* requiring the landlord to give the tenant notice if the tenant had failed timely to exercise a renewal option. In *Deer Cross*, the lease further provided, as summarized by the Supreme Court, that "if the landlord failed to provide timely notice that the tenant had failed to exercise a given renewal option, then the term of the lease was extended past the 'expiration date' to a date which was 60 days after the date that such notice was eventually given by the landlord."

The Supreme Court highlighted the significance of that provision, stating:

Therefore, the lease term was extended until such time as the option was exercised or the lease was terminated and the option therefore had to be exercised within the term of the lease.<sup>10</sup>

In other words, the requirement for the "appurtenant to the lease" exception that the option not be exercisable after the lease had expired was satisfied in *Deer Cross*.

The critical issue for the Appellate Division in *Bleecker Street* was "whether the options are exercisable after the expiration of the lease or only during the lease term." If the former, then the "appurtenant to the lease" exception to the Rule against Perpetuities would not be applicable.

The Appellate Division pointed out that the lease contained no explicit extension of the term of the lease as did the renewal options clause in *Deer Cross*. Indeed, quite the contrary, the lease in *Bleecker Street* contained a provision that "[i]f the term [of the lease] shall have expired, Lessee shall remain in possession as a month-to-month tenant" until the landlord gives the 60-day notice.

The Appellate Division viewed that language as "explicit recognition that the lease term expires if not renewed," thus "establish[ing] that the renewal option clause was intended to give the tenant an ability to renew the lease after it had already expired." As such, the renewal option clause in *Bleecker Street* was comparable to the one in *Warren Street Associates*, i.e., a clause that did not qualify for the "appurtenant to the lease" exception to the Rule against Perpetuities.

The Appellate Division rejected as "a semantic distinction that cannot avail the tenant here" the tenant's argument that a distinction should be made between the expiration of a term of the lease and the expiration of the lease itself. The Court pointed out that the lease defined the phrase "term of this lease" as meaning "the initial term and any renewal term in respect to which Lessee has exercised its right of renewal." It did not include the month-to-month terms created after the term of the lease expires.

Citing two Court of Appeals decisions, *Kennedy v. City of New York*<sup>11</sup> and *120 Bay Street Realty Corp. v. City of New York*,<sup>12</sup> the Appellate Division further noted that a month-to-month holdover tenancy, whether resulting by operation of law when a lease expires or by a holdover provision in a lease, does not extend the original lease term. Instead, "each month is a new term for a new period." Therefore, the court reasoned, the tenant's right in *Bleecker Street* to exercise the renewal options during the month-to-month tenancy that followed the termination of the lease term "cannot satisfy the requirement that the option be exercisable during the lease term," thus precluding it from the category of being "appurtenant to a lease."

Rejecting the applicability of that "appurtenant to a lease" exception, the Appellate Division in *Bleecker Street* held the renewal options clause violated one prong of the Rule against Perpetuities, i.e., the rule against remote vesting codified in EPTL 9-1.1(b). However, the court rejected the landlord's claim that it also violated the other prong of the Rule against Perpetuities, i.e., EPTL 9-1.1(a), and the common law rule against unreasonable restraints on alienation.

EPTL 9-1.1(a) provides in relevant part, at subdivision (2), that:

Every present or future estate shall be void in its creation which shall suspend the absolute power of alienation by any limitation or condition for a longer period than lives in being at the creation of the estate and a term of not more than twenty-one years.

The Appellate Division reasoned that the renewal options clause did "not directly restrain plaintiff from transferring its property." The court recognized that "in theory the options may constitute an indirect restraint on alienation, by reducing the rental value of the building's commercial space and correspondingly reducing the building's sale price." However, the court continued, there was nothing in the record "address[ing] the effect the options may have on the building's sales price," so there was "no basis for finding any indirect restraint to be unreasonable."

In short, the vagaries of the real estate market may impact whether, at any given point in time, it is to the landlord's or the tenant's advantage that a tenancy be for a fixed number of years under a renewal option, rather than month-to-month. As *Bleecker Street* illustrates, the Rule against Perpetuities is a principle of determinative significance as to which category of tenancy exists.

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Endnotes:

1. New York Law Journal, June 26, 2009, p. 25, col. 3 (1st Dept.).
2. *Bleecker Street Tenants Corp. v. Bleecker Jones LLC*, NYLJ, Sept. 3, 2008, p. 26, col. 1 (Sup. Ct. N.Y. Co.).
3. 67 N.Y.2d 156, 501 N.Y.S.2d 306 (1986).
4. 67 N.Y.2d at 161, 501 N.Y.S.2d at 308.
5. 88 N.Y.2d 466, 646 N.Y.S.2d 641 (1996).
6. 58 A.D.3d 480, 870 N.Y.S.2d 333 (1st Dept. 2009).
7. 202 A.D.2d 200, 608 N.Y.S.2d 429 (1st Dept. 1994).
8. Quoted in *Bleecker Street Tenants Corp. v. Bleecker Jones LLC*, NYLJ, June 26, 2009, at p. 26, cols. 2-3 (1st Dept).
9. 2 Misc.3d 401, 773 N.Y.S.2d 211 (Sup. Ct. N.Y. Co. 2003).
10. 2 Misc.3d at 404-405, 773 N.Y.S.2d at 214.
11. 196 N.Y. 19 (1909).
12. 44 N.Y.2d 907, 407 N.Y.S.2d 639 (1978).

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