§ 24.04 Purchase Options*

[1]—Introduction

A purchase option is the right given to a tenant, by contract, to acquire, for consideration, the fee of the building or project in which the premises are located. The option may accrue either at certain designated times during the lease term or may be continuous throughout with the purchase or acquisition fee appropriately adjusted. Purchase options may give the tenant considerable leeway to capitalize on a profitable leasing transaction. Purchase option prices may be set either during the contract negotiation or by appraisal at the time the option is exercised.

The following example illustrates a provision setting out a purchase option.

> **Purchase.** At the end of the fifth (5th) year of the Lease, Tenant shall have an option to purchase the Building in which the Premises are located at the lesser of: (i) the fair market value of the building which is based on buildings of comparable size and character in the city in which the Building is located; or (ii) $[*insert dollar figure*].

[2]—Comment

For many decades, this author has assumed that practitioners and landlords knew that when an option to purchase was granted in a commercial lease, the parties had to tend to the housekeeping issues of the effects on the Landlord & Tenant (L&T) relationship. A specific example is where the parties had to tend to the effects of the common law of equitable conversion or evolution from lease and L&T relationship to vendor and vendee under a purchase contract, even when an election to purchase process did not call for the execution or negotiation of a contract of sale. This assumption was shattered in 2015, when in a period of three months this author was asked to be an expert witness in two large malpractice cases against significant law firms for their failure to protect the landlords in commercial leases they drafted containing options to purchase by the tenants. One was a case involving more than $28 million against the law firm lease drafter for its failure to preserve the rent payment and other performance obligations, such as payment of real estate taxes and maintenance and operating expenses. To understand the cases of concern, it is helpful to understand the typical option to purchase concepts contained in commercial leases.

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The typical text of options to purchase in commercial leases of the 1970s and 1980s generally followed one of two formats. The more common type of clause was for the lease to recite an option to purchase with procedures, notices and timelines for the election and the execution of a form of contract of sale that was generally fully negotiated during the lease negotiation and attached as an exhibit to the lease. At election, the down payment was to accompany the notice of election along with the execution by the tenant of the fully negotiated contract of sale. Generally, title condition, permitted exceptions, and title insurance commitments were in place at the election time. The option text would also prescribe time periods for issuance of the notice of election, payment of the down payment if not with the notice, appraisal or valuation or other calculation of the purchase price, the executory interval between affecting the notice of election of the option and the closing, and such items as the title deliverables and conditions. Such old clauses would also specify that until the closing, all the terms of the lease and L&T obligations to pay and perform would remain unchanged.

The second type of option generally followed the former model and set forth the similar procedures for notice, payment and timing. However, this second tye of option allowed for a period of negotiation of the contract for purchase after the election was affected and would also have fall back procedures in case the parties could not agree to the contract provisions or terms. Under both option election models, the author experienced additional transactional delays for alterations, title insurance, discovery of property condition, as well as title clearing and environmental remediation. In short, most options to purchase would have built in time lags between election of the option, obtaining financing, implementing discovery, obtaining a survey and title insurance and execution of a purchase or closing type documentation. Such time lags were frequently elongated by disputes over valuation and, in many cases, by litigation. This period between successful implementation of the option to purchase and the closing of title to the property will be referenced to here as the executory interval.

For many transactions, the executory interval would elongate for other financial reasons or due to delays in determining the market value of the purchase price or because of party or third-party claims, litigation and injunctions. In some instances, the executory interval instances ran on for years. When a purchase option for property is exercised under a commercial lease, it seems that it is not always clear to some folks (as evidenced by the many requests for expert testimony in malpractice cases) what exactly happens to the L&T relationship between the parties and among superior interest holders such as ground lessors and lenders. There does not seem to be clarity about the impact of the change in the L&T relationship on such continuing duties as rental payment, lease maintenance and other performance obligations of the tenant, or on the rights and obligations of the property owning landlord. If the L&T relationship is impacted by the election and effectuation of the option to purchase, then the interests held by the former landlord and tenant change and the insurance rights and assurances may as well change along with the interests of the parties in condemnation or with the impact of a casualty. In

short, if the lease does not contemplate a change in the relationship and the duties upon election of the option, many things can change without textual attention and determination.

This brings us to the big practice question of what happens upon effective election of an option to purchase under a lease until the time of closing of title to the property if the clause does not address continuation of the lease terms and performance obligations of the parties. Does the lease continue with the tenant paying rent, insuring and maintaining the property, and being responsible for restoration in the event of damage of casualty destruction or is there a relationship and contractual void created from the effective option election until the closing of title to the purchased property? Or does the common law doctrine of equitable conversion still control where the L&T relationship in effect changes to a contract vendor-vendee type of relationship? And if so, how does this impact the continued use and control of the property and the economic interests related to ownership and obligations? As one may suspect, there is a whole body of Real Property Law 101 that we all learned in the first year of law school and that we never again figured to be important. This comment provides a reminder of that hornbook body of law..

Under the common law doctrine of equitable conversion, once the tenant exercises the purchase option in a lease, unless the text of the lease provides otherwise, the lease and L&T relationship "converts" into a purchase and sale agreement or executory contract. The landlord becomes the contract or title vendor (or the seller) and the tenant becomes the contract vendee (or the buyer). The lease is effectively dissolved or merged into the purchase and sale agreement. The tenant then is no longer required to pay rent on the property or perform the other L&T obligations, such as handling insurance, maintenance, repair, compliance with laws, and so on. During the executory interval, especially if it is extended, significant rent payments to the landlord would stop and other fundamental obligations benefiting the landlord and required by other superior interest holders would be extinguished. The economic loss or impact on the landlord and other superior interest holders would be significant. In addition to common law recitations, many states have current case law that has adopted this view. As a result, the tenant's legal, financial, and economic implications can be vast and complex, and are essentially that the tenant is not required to perform as a tenant after election of the option. This is an important area of purchase options under commercial leases about which many practitioners have not been aware of when drafting office leases. What follows are some examples of jurisdictional treatment of commercial leases containing purchase options and the impact on the parties upon election or failure of election, along with practice and procedure pointers. This is not intended to be a jurisdictional survey, so only a few illustrative cases are reflected and analyzed. Rather, it is intended to be a commentary on commercial leasing options to illuminate for the practitioner the dangers of such options, along with practice tips raised by selected cases.

[3]—Case Studies

[a]—Richard Barton Enterprises, Inc. v. Tsern

[i]—Case Summary

The issue in Richard Barton Enterprises, Inc. v. Tsern[1] was whether the lessor (Tsern) had the duty to repair the premises in question, a commercial building space in downtown Salt Lake City, once the lessee (Barton) exercised the option to purchase under the lease. The Utah Supreme Court found that the general rule is that a lessee's exercise of an option to purchase terminates the lease and all *future* obligations under the lease.[2] If the court finds that there was an obligation to repair the property before exercise of the option occurred, then the lessor will still be held liable for damages.[3] Tsern's obligation here was to repair an elevator, which was included in the contract for the sale of the premises.[4] The obligation to repair the elevator existed before Barton exercised the option to purchase, and thus should have been completed before the election.[5] Once the option had been exercised, the relationship became one of vendor-vendee, and therefore the rights of the parties were determined by the contract of sale.[6]

In terms of damages on the exercise of a purchase option, a seller is entitled to interest on top of the purchase price as long as the buyer is in possession of the property during the election period, and regardless of whether the seller caused delays in closing.[7] If the buyer does not have possession and the seller causes delays, then the interest starts from the date of possession.[8] The court found that Barton

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[1] Richard Barton Enterprises, Inc. v. Tsern, 928 P.2d 368 (Utah 1996).

[2] *Id.* 928 P,2d *at* 378.

[3] *Id.* 928 P,2d at 379.

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.,* 928 P,2d at 381.

[8] *Id.*

was in possession during the disputed time, and therefore owed interest on the purchase price from the time the option was exercised.[9]

[ii]—Case Comment

Several issues were raised by*Richard Barton Enterprises, Inc. v. Tsern*, in addition to the conversion to a vendor/vendee contract from a lease and L&T relationship, that are generally not addressed in common law treatments on this topic. The more obvious one is the survival of certain pre-equitable conversion obligations of the parties after the dissolution of the lease and L&T relationship. Survival of obligations is not assured across the jurisdictions. In addition, conversion of obligations during the continued occupancy by the now contract vendee from rent to interest on the purchase price is a surprise to this author. The difference between say $70 per rentable square foot of annual rent versus maybe 3% annual interest on the purchase price for the occupancy period during the executory interval should be just gigantic.

The termination of all lease obligations during the executory interval commencing with the effectiveness of the purchase option election is not surprising. However, for an occupancy or holdover use value to be imputed to the property--owning former landlord of interest on the purchase price, but no imputation of other lease obligations, seems draconian. This case effectively shifts maintenance, repair, restoration from fire, casualty or condemnation and other compliance with law obligations to the property owner for the executory interval until delivery of title to the property to the former tenant/optionee, but continues rights of use and occupancy in the former tenant in exchange for interest on the purchase price. One would wonder why a per diem of other apportioned costs such as real estate taxes and CAM would not also be imputed and apportioned as would be the typical case for a delayed purchase title closing. In any event, this is a material alteration of the economics of the L&T relationship at election and must be addressed by practitioners when drafting the lease.

Another obvious concern would be the maintenance of property insurance and commercial general liability insurance by the parties post-option election. The natural inference and extension of the case logic would suggest that delivery of the property at closing in the condition existing at the option election would be the former landlord's obligation. So that if the tenant under the lease were the party to insure the bricks and mortar, a fire or other casualty that materially destroyed the property would be a title closing problem with possible uninsured liability and impact.

[b]—Ruffolo v. Jordan

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[9] *Id.*

[i]—Case Summary

In the Illinois case of *Ruffolo v. Jordan,* [10] a commercial tenant veterinary practice filed suit against a landlord seeking specific performance of selling a leased premise to the tenant after exercise of the purchase option. Ruffolo (the tenant) did not pay rent during the election period, alleging that she was no longer a tenant but rather a contract purchaser.[11] The tenant argued also that she stopped paying rent after the six-month option period expired because she was the equitable owner of the property.[12] The landlord claimed that rent is owed because parties could not agree on certain aspects of the deal, including a third-party appraiser, an appraised value, a closing date, tenant's rent obligations, etc.[13] The court found that generally upon the exercise of an option, the relationship of lessor and lessee terminates, and the relationship of vendor and vendee takes over.[14] The proper exercise of an option creates a present contract for the sale of property.[15] However, a contract for sale was not formed in this case because essential terms such as the sale price are needed.[16] The lease did not terminate until the parties' rights and obligations under the option purchase agreement were fully determined.[17] An interesting part is that the court stated that the parties had both a landlord-tenant relationship and a vendor-vendee relationship concurrently, "with the lease governing the rental relationship and the option contract governing the purchasing relationship."[18]

The tenant was therefore found to owe the discontinued rent payments to the landlord up until the date of the appraisal because that is when the tenant became the equitable owner of the property. The

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[10] Ruffolo v. Jordan, 41 N.E.3d 536 (Ill. 2015).

[11] *Id.* 41 N.E.3d at 538.

[12] *Id.* 41 N.E.3d at 541.

[13] *Id.*

[14] *Id.* 41 N.E.3d at 542.

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

tenant was also entitled to purchase the property through specific performance for $525,000, as this was found to be the appraised value.

[ii]—Case Comment

TheThe *Ruffalo v. Jordan* case both fascinating and an excellent case of judicial grafting and overlaying. Basically, there are several lessons to be learned from this case that apply in any jurisdiction:

(1) The equitable conversion from L&T to contract vendor/vendee may be determined to occur only at effective election of the purchase option. Faulty election or defective election may impair the conversion, delay it, or overrule it.
(2) Elongated elections with conditions precedent, such as setting a purchase price via appraisal or arbitration procedures/proceedings, may continue the L&T relationship until the essential term of the purchase option is effectuated. If essential terms of the purchase are not provided in the option or lease text, the option election and option itself may fail for lack of specificity or essential contract terms and the L&T relationship may either continue or possibly the lease may end, but the purchase may not occur. This is a dangerous result for a practitioner. Therefore, the take-a-way from this case is that the essential and fundamental terms of a purchase must be accommodated and prescribed by the option language. Additionally, if the executory interval is to start at the notice or election of the option, then the processes following for appraisal, arbitration or other conditions to title should be specified as post-election functions or as conditions precedent. Finally, as a practice tip, there should be no procedure or process without a mandated solution in the language of the option so as not to create an open ended executory interval.
(3) It would be a relief if all jurisdictions espoused that during the executory interval the parties continued to enjoy the L&T relationship and obligations, and that the parties are converted to contract vendor and vendee for title related closing processes. However, even in this case, it is muddled and other jurisdictions do not recognize dual or concurrent L&T and contract vendor/vendee relationships, but rather adopt the conversion of one to the other with few surviving L&T obligations, if any.

[c]—Rich v. Rosenthal

[i]—Case Summary

In Rich v. Rosenthal, [19] Rosenthal sued the executor of deceased landlord for specific performance of a provision in a lease agreement giving the tenant an option to purchase the two-story building where

[19] Rich v. Rosenthal, 268 S.W.2d 884 (Ark. 1954).

tenant owned a store on the first floor.[20] The main issue in dispute in terms of the impact on the L&T relationship was: whether Rosenthal forfeited his right purchase under the option by not paying rent after the exercise of the option.[21] The court found that when the option to purchase is duly exercised, the relation of L&T ceased and that of vendor and vendee arose.[22] The lessor may not force the continuance of the L&T relationship for the purpose of creating a breach of covenant to pay rent as to declare the option forfeited by the tenant.[23] At the same time, the lessee may not renounce his election and reelect to hold under the lease, absent a provision in the contract stating otherwise.[24] Since Rosenthal wrote a letter properly exercising the option and offered to put up the money to anyone who was an executor of the landlord, the court found that he was correct in filing a suit for specific performance, and that unpaid rent was not ultimately due.

[ii]—Case Comment

The *Rich v. Rosenthal* case is truly creative and amazing. It is the first and only case this author has encountered that grafted an "un-election" or rescission of an election of an option to purchase that would reverse the affect of equitable conversion--an equitable conversion poison pill if you like. All options this author has encountered or written in commercial leases have contained text basically stating that the the election of the option is irrevocable, and can only be undone or dissolved upon failures of tenant to continue paying and performing as required by the continued provisions of the lease. Such would mean continuing the L&T relationship, the lease provisions, and the default and termination provisions. While *Rich v. Rosenthal* is instructive on issues of continuity and irrevocability of options and conditions subsequent for tenant's defaults under the terms of the lease or payment and compliance with the purchase contract obligations, it does not provide a good foundation for the concept of "un-election" of an option to purchase and is otherwise without legal or logical foundation.

[d]—Summa Corporation v. R0ichardson

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[20] *Id.* 268 S.W.2d at 885.

[21] *Id.* 268 S.W.2d at 886.

[22] *Id.* 268 S.W.2d at 889.

[23] *Id.*

[24] *Id.*

[i]—Case Summary

In Summa Corporation v. Richardson,[25] Summa Corporation, the assignee of two leases, sued lessors for specific performance regarding options to purchase certain property.[26] The lessor claimed that Summa breached the terms, conditions and covenants of the lease on multiple occasions, which would render a forfeiture of the option.[27] The court found that a lessor's acceptance of rent payments with knowledge of prior breaches is sufficient to constitute a waiver of conditions prior to the exercise of the purchase option.[28] Only after Summa's exercise of the option did the lessor use the breaches as an argument to show that Summa forfeited the right to exercise the option.[29] However, the court stated that lessors cannot rely on alleged breaches after the purchase option because upon exercise of the option, the landlord-tenant relationship ends, and it is converted to one of vendor-vendee.[30] The court therefore found in favor of Summa Corporation and ordered specific performance as the proper remedy.[31]

[ii]—Case Comment

The *Summa Corporation v. Richardson* case raises some unknown issues on options and elections, and seems to overrule the survival of remedies, damages and pre-option election performance by the parties as illuminated in the first two cases. The take-a-way practice tips from this case are:

(1) Practitioners must address and protect against the possibility of *in personam* option rights which vest by the lease text only in the "First Above Named or Named Tenant" and which therefore may not survive assignment of the lease.
(2) Practitioners also must assess the fragility of option rights which in the option clause or elsewhere in the lease are made contingent on status of defaults existing at the time of the election of the

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[25] Summa Corp. v. Richardson, 564 P.2d 181 (Nev. 1977).

[26] *Id.* 564 P.2d at 182.

[27] *Id.* 564 P.2d at 184.

[28] *Id.* 564 P.2d at 185.

[29] *Id.*

[30] *Id.*

[31] *Id.*

option or thereafter occurring which terminate the option and reinstate the lease and L&T relationship, or more dangerously terminate the option effectiveness and terminate the lease. These provisions can occur or appear in various sections of the lease outside the option clauses, so the full lease text must be read to protect against this impairment of the option or lease continuance.

[e]—Pitman v. Sanditen

[i]—Case Summary

In Pitman v. Sanditen,[32] Pitman leased a hotel in Laredo, Texas from Sanditen Properties with an option to purchase the underlying land.[33] The lease agreement stated that upon exercise of the option by written notice, "a contract shall exist between lessor and lessee for the sale and purchase of the Real Estate."[34] After proper exercise of the option in January, with a closing date in March, Sanditen refused to go through with the purchase if Pitman did not pay the rent that was allegedly due up to March 1st.[35] Sanditen sued for termination of the lease and forfeiture of the purchase option.[36] Sanditen argued that the agreement specifically stated that if Pitman defaults under the lease prior to the closing of the purchase option, then a forfeiture would have occurred.[37] The Texas Supreme Court disagreed with this provision and held that when a tenant exercises an option to purchase under a lease, a binding, bilateral contract is formed.[38] In such a case the landlord-tenant relationship ceases and a vendor-vendee one arises.[39] The court found the purchase and sale agreement to be controlling rather than the contradictory language of the original option provisions (referring to the parties as lessor and lessee,

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[32] Pitman v. Sanditen, 626 S.W.2d 496 (Tex. 1981).

[33] *Id.* 626 S.W.2d at 496.

[34] *Id.* 626 S.W.2d at 496–497.

[35] *Id.* 626 S.W.2d at 497.

[36] *Id.*

[37] *Id.*

[38] *Id.* 626 S.W.2d at at 498.

[39] *Id.*

and stipulating obligations under default and forfeiture of the lease).[40] Pitman was therefore entitled to specific performance of the contract to purchase because the option was properly exercised; and with a contractual relationship, no further rent was due.[41]

[ii]—Case Comment

The author wishes to thank the Texas court for a clear recognition of the concept of common law equitable conversion without the survival of terms or obligations or the ability to graft over default conditions subsequent to invalidating or terminating the effectuated option to purchase. *Pitman v. Sanditen* also illuminates the need for additional post-option election and executory interval recitations of economic needs of the former L&T parties from election until title closing.

[f]—Madison v. Marlatt

[i]—Case Summary

In Madison v. Marlatt,[42] there was a dispute over a three-year farm lease agreement between the Marlatts (lessees) and Madison (lessor).[43] Lessees instigated the initial lawsuit after exercising the alleged option to purchase under the lease by payment of a cashier's check for the purchase price of $40,000.00.[44] Madison refused to convey the leased property and as a result, the Marlatts sought damages for breach of contract.[45] The court stated that in Wyoming, an option contract is a unilateral contract, in which the lessor promises not to revoke an offer to sell for a specific period of time.[46] The contract becomes a bilateral one that is binding on the parties if the lessee exercises the option within

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[40] *Id.*

[41] Id.

[42] Madison v. Marlatt, 619 P.2d 708 (Wyo. 1980).

[43] *Id.* 619 P.2d 708 at 710.

[44] Id.

[45] Id.

[46] *Id.* at 714.

the specific period of time.[47] The court held that because the contract had a viable option, the option was exercised for the fixed purchase price, and no other negotiations were necessary, [48] and Marlatt would be able to legally exercise the option and purchase the farm property.[49]

[ii]—Case Comment

Although *Madison v. Marlatt* is a simple and straightforward case, it should not be relied upon for brevity of text in any option situation, unless it is for an inexpensive farm in Kansas or Wyoming!

[g]—Koppelman v. Barrett

[i]—Case Summary

In *Koppelman v. Barrett,* [50] the Barretts entered into a lease with their landlord that contained an option to purchase the premises for $2,500,000 upon thirty days written notice during the term of the lease.[51] The trustee of the landlord filed this suit against lessees for unpaid rent during the election period after the Barretts exercised the option to purchase and provided a down payment, but there had been no closing.[52] The Barretts remained in possession of the property during that time without paying rent.[53] The lessees moved to dismiss the case, claiming that there was no longer a landlord-tenant relationship after the option was exercised and they became contract vendees in possession of the property.[54] The court stated the rule in New York to be: "where a tenant exercises an option to purchase contained in a lease, the relationship of landlord and tenant ceases and, absent an intent to the contrary, the tenant is

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[47] *Id*.

[48] *Id.* at 715.

[49] *Id.*

[50] Koppelman v. Barrett, 17 N.Y.S.3d 584 (N.Y. App. Term. 2015).

[51] *Id.* 17 N.Y.S.3d at 585.

[52] *Id.*

[53] *Id.*

[54] *Id.*

a vendee in possession against whom the landlord cannot maintain a holdover proceeding."[55] However, the Barretts were found to have exercised the option too late, after the original lease term had expired.[56] The court held that no rent was due since the lease had terminated, and the option to purchase was no longer valid.[57]

[ii]—Case Comment

Very straightforward on the common law equitable conversion, the end of the L&T relationship and obligations. the *Koppelman v. Barrett* decision is extremely important and instructive on time is of the essence or failure to timely exercise a purchase option, as well as conditions for effective or substantial election and equity rules for effectuating an option.

[h]—Twelfth Ave. Investments, Inc. v. Smith

[i]—Case Summary

In *Twelfth Ave. Investments, Inc. v. Smith,*[58] Smith, the lessee, sued for specific performance of a purchase option contained in a lease agreement for commercial property against Twelfth Avenue Investments, Inc. (Twelfth), the lessor.[59] Smith sent a notice by letter to a representative of Twelfth electing to exercise the purchase option offering $1,500,000.[60] The offer was rejected and a counteroffer was made of $3,800,000.[61] Smith rejected that counteroffer and replied that he wanted to proceed to a board appraisal, pursuant to Article IV of the lease agreement.[62] Twelfth replied with

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[55] *Id.*

[56] *Id.* at 586.

[57] *Id*.

[58] Twelfth Ave. Investments, Inc. v. Smith, 979 So. 2d 1216 (Fla. Dist. App. 2008).

[59] *Id.*, 979 So.2d at 1218.

[60] *Id.*

[61] *Id.*

[62] *Id.*

names of appraisers, but eventually through its attorney notified Smith that he had no right to exercise the purchase option, and had to vacate the property by a certain date.[63] The court held that where there was an option to purchase, lessee's proper notification of the lessor of the lessee's decision to purchase the property is "all that is required to exercise that option."[64] The court also stated that once notice is given, "the option became a bilateral contract, binding on both parties, and susceptible of enforcement by a court of equity in a suit for specific performance."[65] The court affirmed the lower court's decision and awarded specific performance to Smith because the lease ended once the option to purchase was exercised, and the purchase and sale agreement then controlled.[66]

[ii]—Case Comment

While *Twelfth Ave. Investments, Inc. v. Smith* is simple and straight-forward, this case also raises the need to have language in some jurisdictions to preserve the option election during the determination of the purchase price and maybe other terms, and to avoid the determination in *Ruffolo v. Jordan* [67] above where the contract failed because certain essential contract terms were not established in the option text.

[i]—Atlantic Richfield Co. v. Couture

[i]—Case Summary

In *Atlantic Richfield Co. v. Couture,* [68] Atlantic Richfield Company (ARCO) sued to enjoin lessors from prosecuting a summary process action and for specific performance to convey real estate.[69] The lease of

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[63] *Id*.

[64] *Id.,* 979 So.2d at 1219.

[65] *Id.*

[66] *Id.,* 979 So.2d at 1220.

[67] Ruffolo v. Jordan, 41 N.E.3d 536 (Ill. 2015).

[68] Atlantic Richfield Co. v. Couture, 344 N.E.2d 917 (Mass. App. Ct. 1976).

[69] *Id.* 344 N.E.2d at 918.

twenty years on the property contained an option to purchase for $45 million.[70] Lessors orally complained to ARCO about the appearance of the property (a gas station and garage type business), and eventually wrote to ARCO that it intended to terminate the lease if the "premises was [*sic*] not maintained and kept in good order" which would constitute a breach of the lease.[71] A little over a month later, ARCO notified the lessors that it was exercising its purchase option and set forth a closing date with its attorneys.[72] The lessors did not reply to ARCO's letter and instead filed the original lawsuit.[73] The court found that the lower court's ruling was correct: ARCO's notice of the exercise of the option *converted* an offer into a contract for purchase and sale that required lessors to convey the leased property to ARCO upon payment of the purchase price.[74] The court also noted that the lower court decision that ARCO breached the lease because of a disheveled property was not material in its decision on appeal.[75]

[ii]—Case Comment

The *Atlantic Richfield Co. v. Couture* case is included to call the practitioner on the *obiter dicta* at the end of the ruling. It seems to suggest that a breach of the lease terms was identified by the tenant without formal notice of default or termination notice being issued by the landlord was of some consequence to the lower court. As a reminder, if the intention of the parties is to have conditions precedent or subsequent to the effectiveness of an option relating to performance, defaults or other conditions, those conditions should be spelled out in the option language. It may be gleaned from the case that the existence of a default without lease termination prior to the exercise of the purchase option was relevant, even though the appellate judge did not consider it to be material.

[j]—Wolk v. Widlansky

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[70] *Id.*

[71] *Id.*

[72] *Id.* 344 N.E.2d at 919.

[73] *Id.*

[74] *Id.* at 920.

[75] *Id.*

[i]—Case Summary

Wolk v. Widlansky [76] is an interesting New Jersey case that provides an example of when a tenant does not successfully exercise the option to purchase, and therefore is still considered a tenant instead of a contract vendee. Wolk sued Widlansky to require conveyance of property upon an alleged acceptance of a written option to purchase contained in the lease.[77] Wolk visited the property and orally informed the lessors of his desire to purchase the property through the option, but the lease expired the next day, March 1, 1946.[78] Despite the lease expiration, Wolk continued to pay rent at an increased rate until March 10 of the next year (1947)when the lessors notified him to vacate the premises.[79] The court found that because Wolk continued paying rent as lessee, and an oral agreement was not sufficient to exercise the purchase option, Wolk was never considered a purchaser.[80] Wolk was found to be a tenant that was paying rent voluntarily to lessors.[81] Because of this, the court held that the purchase option was never exercised and the court dismissed the case.[82]

[ii]—Case Comment

It is the author's belief that the *Wolk v. Widlansky* case is self-illuminating and needs no comment.

[k]—Conclusion

As the presented cases demonstrate, the economic impact from absence of language in options to purchase under commercial leases can be extreme. The failure to define the condition of title and delivery condition of the purchased property can leave large gaps in the obligations and expectations of the parties at the closing of the title. If counsel finds herself or himself confronted at closing with environmental contamination at the property, violations of laws or other failures of structure or building

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[76] Wolk v. Widlansky, 59 A.2d 407 (N.J. Ch. 1948).

[77] *Id.* at 408.

[78] *Id.* at 409.

[79] *Id.*

[80] *Id.*

[81] *Id.*

[82] *Id.*

systems, relying on equitable conversion or implied contract or custom of title is not a good place to be. This author was asked to provide expert testimony regarding many of these issues. In addition to an elongated executory interval under the resulting contract for sale, the property was in the process of development permitting and development. The several years of dispute resolution regarding the purchase price and litigation over the responsibilities and rights/values of the permitting, infrastructure, and rentals amounted to a material part or percentage of the purchase price without textual mechanisms for allocation or determination of responsibility in the lease option text. The text of the option also did not assign insurance or real estate tax responsibilities during the executory interval. Had there been a loss due to fire or other casualty or condemnation of the development before completion of the improvements to the property, the process of resolution would have been unfathomable to this author.

The affect of the equitable conversion of the lease to contract vendor/vendee would disrupt the insurable interests of the parties and might partially confuse or invalidate the current policies of coverage. In addition, if there were lenders involved, the impact on the loans for debt service, insurance indemnities, and title would come into play. Further, release of the property from the lien of the mortgages upon dissolution of the lease might be complicated, as well as the impact on any other superior interest such as ground leases, master leases, and reciprocal easement agreements. In such complex structures, the leasehold financing would have the leasehold mortgagee's lien dissolve,. Since the leasehold would have terminated, the leasehold lien of the lender's loan would not attach to the property until the closing of the purchase, if ever, provided no other specific items were applicable.

There is the interesting situation of the option being terminated due to a optionee/tenant default. If the elected option is later terminated or fails because of a condition subsequent during the executory interval, the property condition may change during the occupancy and control of the former tenant/contract vendee and the property may become subject to contamination, liens for real estate taxes, or other encumbrances. In these circumstances, the obligations of the parties would be uncertain whether or not the closing of title to the property occurred.

It would likely be good practice in all options to address the effective election process, the condition of title at closing, all essential terms customarily found in contracts of sale, the affect of defaults under the lease, the continuation of the L&T obligations during the executory interval, and related enforcement procedures, as well as to have the down payment presented with the notice of election of the option. As can be seen from the cases discussed here, it would also be wise to have a fully negotiated contract of sale attached to the ease to guide the parties on closing deliverables, even if the purchase price is to be determined by appraisal or other process. Finally, express statements dealing with any rights to terminate the option after election or after termination of the option due to conditions subsequent should be expressly addressed in detail, along with restoration of the title and condition of the property.

If the purchase fails and a funding or security such as a letter of credit exists, that is issued by the purchaser/vendee to secure the restoration obligations.

A related topic of interest is the condition of title to a property, as well as the entitlements during the zoning, permitting, and construction of the property. Properties in change are at risk if the common law equitable conversion occurs without addressing survival of the lease and ownership of the entitlements, abatements, incentives and permits, and zoning rights. The common law doctrine of merger is relevant here. If the lease terminates and title vests in the former tenant (now the contract vendee), do the zoning and development permits, incentives, abatements, bonuses and easement rights also move automatically to the new transferee or do they possibly disappear as would the lease? It is custom and practice under master leases to require, in the text of the master lease, that even if title to the property and the lessee's interest in the lease merge into the purchasing entity, the lease survives and the doctrine of merger will not operate. It is often said by experienced practioners that when the doctrine of merger operates, the title merger combines all the various property interests in addition to the leasehold and leasehold liens into the same fee simple when those interests come into the same ownership and control. This is known as "unity of title." All interests including easements, reciprocal easements agreements, servitudes, deed and use restrictions, life estates, and any other interests effectively "merge" or disappear into the fee (title). Therefore, in cases involving complex properties or development complexes, application of the merger doctrine of merger should be anticipated and accommodated.