PLAIN SPEAKING FROM A LAWYER

EXERCISE OF LEASE OPTIONS: IS THE STRICT COMPLIANCE RULE FAIR? DON'T ASK – JUST COMPLY!

By Jim Hochman

There are many reported cases, in Illinois and indeed across the country, where a tenant had an option, whether to expand, extend, or renew a lease, or even to terminate the lease, and through inadvertence, even though negligence, something happened, or didn't happen, and landlords and tenants found themselves in court. We know from experience that litigation is painful, not only for the uncertainty of outcome, but also for the certainty of the expense.

Illinois is a "Strict Compliance" state. What this means is that generally, unless a tenant exercises an option in the precise manner and with notice to the requisite parties, the Court will rule that the option has lapsed. Recent examples include Genesco Inc. v. 33 North LaSalle Partners LP, 383 Ill App. 3d 115 (1st Dist., 2008) and Thomson Leasing Inc. v. Olympia Properties LLC 365 Ill App. 3d 621 (2d Dist., 2006). In each of those cases, tenants failed to strictly comply with option requirements, and while each had made reasonable equitable arguments why they should be excused from strict compliance, each was unsuccessful in the end. Here is what happened and why.

In Genesco, a Sub-Tenant gave timely but oral notice of its intent to exercise a termination option, then sent the written notice to the Sublessor (but not the Landlord) and then sent notice to the Landlord at the wrong address. The Sub-Tenant also erred when it sent the check for the termination fee to the Sublessor, not to the Landlord. This Sub-Tenant made all of the "right" arguments for equitable relief, that delay in strict compliance was slight, that the Sub-Tenant would suffer undue hardship if strict compliance was not excused, and that Landlord would not suffer prejudice if strict compliance was excused.

The Court, relying in part on the 1900 Illinois Supreme Court case of Dikeman v. Sunday Creek Coal Co. 184 Ill 546 (1900) and in part on language in the lease ("Time is of the essence"), denied the Sub-Tenant the relief that it requested, i.e. the right to terminate the sublease. Instead, the Court reasoned that the parties to a commercial lease are deemed to be sophisticated business persons who should be held responsible for their acts or omissions, that landlords generally receive no consideration for options, and a party's failure to read the lease – and failure to seek legal counsel – should not be excused.

It appears (with hindsight) that each of the Sub-Tenant's errors could have been avoided with some care, attention to detail, and of course a careful reading of both the sublease and the lease.

In Thomson Leasing Center Inc. v. Olympia Properties LLC 365 Ill App. 3d 625 (2d Dist. 2006), the strict compliance rule was applied in a similar manner, despite slightly more compelling facts in favor of the tenant. Here, the tenant not only gave oral notice of its intent to exercise its option to terminate, it wired the cancellation fee to the Landlord, who acknowledged receipt of the wire. Landlord claimed it received no written notice of exercise of the option and returned the funds. The Tenant tried to claim it had sent a letter exercising the option to terminate the lease but the proof was ineffective – and did not persuade the Court. The Court added, in citing a commentator from out of state "To relieve parties of their obligations in this area... while occasionally appealing... is....disruptive to commercial expectations." The Court added that while enforcement of the rule of strict compliance might lead to harsh results, the rule tends to enforce commercial certainty.

There are a few cases where Courts granted Tenants equitable relief from the strict compliance rule. In Gold Standard Enterprises Inc. v. United Investors Management Company, 182 Ill App. 3d 840 (1st Dist., 1981), the Court excused late notice of exercise due to a shortage of postage on the letter by $.20, resulting in return of the letter. In Linn Corp. v. LaSalle National Bank, 98 Ill. App. 3d 480 (1st Dist., 1981) the Court excused late exercise of an option to renew a lease, where the notice was given 9 months, instead of 12 months prior to the renewal date. The Court was persuaded that the failure to give timely notice was careless but the error was outweighed by the loss the tenant would suffer, having spent $200,000.00 on leasehold improvements, if the lease was not renewed. In Providence Insurance Co. v. LaSalle National Bank 118 Ill App. 3d 720 (1st Dist. 1983) the Court excused late notice of exercise of an option to purchase land adjacent to the leased space, when the notice arrived only 1 day late, because the delay was not caused by the tenant's carelessness or negligence.

In MXL Industries Inc. v. Mulder, 252 Ill App. 3d 18 (2d Dist., 1983), the tenant suffered a harsh lesson, and a judgment for all of the rent due for the remainder of the lease term, plus the landlords attorney's fees when it tried to be just a bit too clever. This tenant exercised its option to terminate the lease timely but instead of sending a check in the full amount of the termination fee, it asked/asserted that its $3,000 security deposit be applied to the termination fee. When the Landlord asserted damage to the leased space required application of the security deposit to repair the damages, failed negotiations on the last issue led to litigation. When the Court applied the strict compliance rule (the tenant failed to tender the full termination fee), the result was a judgment of approximately $300,000 against the tenant.

What we learn from these examples is that it is never a good idea to rely on the possibility of relief from a party's failure to read, understand, and observe the requirements of the lease it has signed. In fact, I would even go out on a limb and add that even for those few parties who received equitable relief from their failure to strictly comply, these "fortunate" parties, would likely admit that they wished instead, that they had strictly complied and thereby could have avoided the uncertainty of litigation with the certainty of its expense. ▽

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