

Real Estate Title Insurance & Construction Law

Right of First Refusal To Lease Additional Space Terminates Upon The Expiration of the Lease Term

By Arnold D. Litt

In a case of first impression in New Jersey, the Appellate Division held that a tenant's right of first refusal for additional space in a building terminated upon the expiration of the lease term, notwithstanding the tenant's holdover as a month-to-month tenant. In *Fedderly v. Skoda*, 2009 WL 2044668 (N.J. Super. Ct. App. Div. July 15, 2009), a per curiam decision on appeal from the Superior

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Court of New Jersey, plaintiff/appellant Fedderly appealed from an order entered in the law division granting defendant's motion for summary judgment. The case involved a commercial lease agreement between tenant Fedderly and landlord Skoda dated November 1994 in which Fedderly reserved the right of first refusal when additional space in the building became available. The original lease contained renewal options, which plaintiff took advantage of, with the last option expiring on November 30, 1999. The lease was then amended to permit year-to-year extensions subject to "the exact terms and conditions of the old lease." The final year of the extended term expired on November 30, 2003. At this point defendant notified plaintiff he intended to lease plaintiff's space to Wachovia Insurance Agency but the plaintiff did not agree to vacate the premises. Plaintiff remained in the space as a holdover tenant. On January 30, 2006, defendant delivered a "notice of termination/mutual release/notice to vacate,"

which plaintiff refused to sign as he claimed defendant's failure to extend the right of first refusal "estopped defendant[] from compelling plaintiff to vacate."

After filing in the Morris County chancery division, where plaintiff was denied injunctive relief from the notice to vacate, the court found that the right of first refusal expired when the plaintiff became a month-to-month tenant, the case was transferred to the law division and referred to arbitration to settle damage claims. Defendant sought a trial de novo, both parties "cross-moved for summary judgment," and the defendant's motion was granted. The court held that a "right of first refusal [for additional space], which [, upon exercise,] ripens into an option contract, does not survive expiration of a written lease because (1) a right of first refusal is a collateral agreement, independent of the lease and concerns only additional space and not the leased space; and (2) plaintiff's right of [first] refusal only applied if plaintiff wished to increase his leasehold during the written lease term." In short, plaintiff was required to exercise his right of first refusal prior to the termination of the final lease renewal term.

The *Fedderly* court relied upon *Andreula v. Slovak Gymnastic Union Sokol Assembly No. 223*, 140 N.J. Eq. 171 (N.J. 1947), which involved an action for specific performance concerning an

option to purchase. The original written lease was for a period of two years and included an option to purchase. When the lease expired the tenant remained as a month-to-month holdover. Upon learning that the property was going to be sold to a third party, the tenant offered to purchase the premises. The *Andreula* court held that "an option [to] purchase is not to be regarded as a provision incident to the relation of landlord and tenant, but is a matter collateral to and independent of it" and therefore could not be exercised during a holdover period. The *Fedderly* court extended the *Andreula* decision reasoning that a right of first refusal ripens into an option contract upon its exercise, it is independent of the landlord/tenant relationship, and cannot be exercised subsequent to the expiration of the lease term because it has already terminated.

New Jersey's position is consistent with other jurisdictions: see, *e.g.*, the New York case *White Castle System, Inc. v. Blohm*, 807 F.2d 313, 315 (2d Cir. 1986), in which the United States Court

of Appeals, applying New York law, held a right of first refusal to purchase the property exercised after the lease term expired was unenforceable. The court examined the parties' intentions and found that the

parties understood that the right of first refusal was not to continue, and this understanding negates any implication of such a term into the holdover tenancy. Nor is the right of first refusal continued by virtue of N.Y. Real Prop.Law § 232-c (McKinney 1968), a statute that provides only that a holdover creates a month-to-month tenancy absent express or implied agreement otherwise.

The court's focus upon the "understanding" of the parties suggests that a contrary decision might have issued if the court found the facts established that the landlord and tenant agreed to extend the right of first refusal after the lease had

expired. See also *Schaefer v. Thompson*, 237 N.Y. 55, 58 (N.Y. 1923), in which the Court of Appeals of New York found that it was the plaintiff's "duty to insist upon her option and tender full performance on her part before the expiration of her lease as prescribed in the contract." The court denied plaintiff's option to purchase after the expiration of her lease term.

The lesson of *Fedderly v. Skoda* is clear: in drafting leases that contain rights of first refusal or options to renew, purchase, expand, relocate or otherwise, the practitioner should ensure that the lease should provide clear and precise language specifying that any such right expressly expires at the end of the lease term or renewal term and will not apply to a holdover tenancy. Anything less than this may run the risk of a court finding in favor of a holdover tenant based upon the supposed "intention" of the parties to the contrary and raises the specter of the court interpreting the lease language to extend a right of refusal or option to holdover tenancy. ■