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Timely lease extensions: The unforgiving rule of *Chesapeake Bank*



By Kevin L. Shepherd

A tenant who misses a lease extension option deadline by 27 days is out of luck according to a recent decision by Maryland's intermediate appellate court. (*Chesapeake Bank of Maryland*

v. Monro Muffler/Brake, Inc., No. 2288, Sept. Term. 2004, Jan. 31, 2006 (Md. Ct. Spec. App.)) Although this case provides commendable bright-line guidance to real estate landlords and tenants on lease extensions, the case is unforgiving to those tenants who are untimely in exercising lease extension options.

Facts

Chesapeake Bank of Maryland and Monro/Muffler/Brake Inc., through its predecessor in interest, entered into a 20-year lease in 1981 that expired on Oct. 31, 2002. The lease contained three successive options to extend the lease term for terms of up to five years each. The lease provided the following procedure for exercising the extension options:

If LESSEE shall elect to exercise one or more of such options it shall do so by giving LESSOR written notice at least ninety (90) days prior to the expiration of the primary term or of the then current extension, and in such notice LESSEE shall state the date to which it elects to extend the term.

In an estoppel certificate Monro sent to the bank on March 20, 2002, Monro confirmed the Oct. 31, 2002 expiration

date and the extension options noted above. A letter from Monro to the bank on May 8, 2003 expressed Monro's desire that the bank and Monro have a "long and prosperous relationship."

Monro notified the bank by a letter dated Aug. 29, 2002 that Monro elected to exercise its option of extending the lease for a five-year term. In the bank's letter to Monro dated Sept. 5, 2002, the bank refused to confirm the lease extension, indicating that the deadline for exercising the extension option was Aug. 2, 2002. Monro missed the 90-day deadline

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because its vice president of real estate inadvertently entered into Monro's computer a reference to 60 days rather than 90 days for the lease extension notice deadline.

The lease also contained a purchase option in favor of Monro. Monro, which refused to vacate the property, notified the bank in late September 2002 that Monro was exercising its purchase option. Although both the bank and Monro obtained appraisals of the property, Monro ultimately decided not to buy the property because of zoning issues.

Competing lawsuits were filed by the bank in the district court and Monro in the circuit court. Pursuant to a consent order from the district court, the cases were consolidated in the Circuit Court for Baltimore County. The circuit court, through now-retired Judge Robert E. Cadigan, granted Monro's petition for renewal of the lease. The Bank appealed, and the Court of Special Appeals reversed the circuit court.

Discussion

Judge James A. Kenney III, writing for the three-judge panel, methodically rejected each argument advanced by Monro in support of its position that (a) Monro's correspondence with the bank demonstrated Monro's intent to exercise its extension option, and (b) equitable principles required granting the extension despite Monro's untimely notice.

In rejecting Monro's argument that its untimely extension notice was nonetheless effective, the court pointed to the objective theory of contract interpretation to the effect that a court will not engage in construing clear and unambiguous contract language. Here, the *Chesapeake Bank* court found that the extension option was unambiguous and that the 90-day notice requirement was a condition precedent to Monro's exercising its option to extend the lease.

Monro contended that its extension notice was not untimely because the pur-

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chase option language effectively extended the lease term until such time that the parties reached agreement on the purchase option. On that basis, *Monro* argued that its notice was timely because it was given 90 days before the “then current extension” of the lease term. The court rejected this interpretation because a “reasonably prudent person” would not have read the lease terms in this fashion.

On the strength of a 1992 opinion by the Maryland Court of Appeals, *Beckenheimer’s Inc. v. Alameda Assocs. Ltd. P’ship*, 327 Md. 536 (1992), *Monro* then argued that its correspondence to the bank effectively worked to extend the lease term.

Under *Beckenheimer’s*, to determine whether a lease renewal was satisfactory, the “test” is to hypothetically reverse the situation and determine whether a tenant would be bound if, based on the prior correspondence, the landlord had been the party seeking to enforce the renewal. The *Chesapeake Bank* court rejected this argument on the basis that *Beckenheimer’s* did not control this factual situation.

The *Beckenheimer’s* court did not create a test to be used in cases involving the timeliness and sufficiency of renewal or extension options: it only considered whether the failure to include a net worth statement alone with a timely notice of the exercise of a renewal option would render the exercise ineffective. Even assuming that *Beckenheimer’s* controlled this case, the court concluded that *Monro* would not prevail in any event because none of the correspondence refers to the extension option and there was no clear manifestation of an intent to accept the extension option within the time period required by the lease.

Monro’s equitable arguments fared no better with the court. The court noted that a landlord has no duty to inform a tenant that an extension notice deadline is approaching or that it has passed. Because *Monro* was not seeking equitable relief from a forfeiture, equity would not save it from the harsh consequences of missing the extension notice deadline. The court observed that *Monro* failed timely to exercise its option, thereby allowing the lease to expire. In a pointed statement, the court stated that “[i]n such a case, the relative hardships are immaterial.”

Monro also argued that Section 8-108 of the Real Property Article of the Annotated Code of Maryland authorizes the court to grant equitable relief. Section 8-108 provides that “[a] court may enter

judgment for the renewal of a lease that contains a covenant for renewal, including a lease for 99 years, renewable forever.” The bank contended that, because the statute applies only to leases that are “renewable forever,” it has no applicability to this case because the lease is not renewable forever. Even if that were an incorrect view, the court reasoned in any event that a court “may” enter judgment for the renewal of a lease that contains a renewal covenant and that Section 8-108 does not dictate that result.

Finally, the court rejected *Monro’s* argument that the failure to give timely notice of extension was a “default” and, therefore, under the default provisions in the lease, could be cured within 20 days of receipt of notice from the bank of the default.

Practical impact

Unless and until the Maryland Court of Appeals addresses this issue authoritatively, the *Chesapeake Bank* case will guide Maryland real estate practitioners in drafting and enforcing lease extension options.

To avoid the unforgiving nature of this case, tenants can try to negotiate protective provisions into their leases. First, a tenant should seek to obligate a landlord to remind the tenant of its right to extend the lease term in time adequate to allow the tenant to do so. Second, a tenant can try to negotiate a provision to the effect that a tenant does not relinquish its extension option unless the landlord first notifies the tenant and allows the tenant a short period within which to exercise the option.

Both techniques, though, are typically unpalatable to most landlords. Landlords generally do not want to be responsible for reminding tenants of looming extension options. A tenant could argue that between the comparatively slight administrative burden placed on a landlord and the tenant’s relinquishment of a valuable contractual right, it would seem equitable that the landlord shoulder this burden. But this argument usually does not prevail.

From a landlord’s perspective, *Chesapeake Bank* teaches the importance of casting the renewal notice provision as a condition precedent to the valid exercise of the extension option. Landlords should check their forms to make sure that the renewal notice provisions are crystal clear on this point.

The *Chesapeake Bank* court used the words “renewal” and “extension” inter-

changeably, but some courts have found that these two words have different legal meanings. An extreme example of this is *Qureshi v. Fiske Capital Management*, 796 N.E. 2d 459 (Mass. App. Ct. 2003). In *Qureshi*, the court indicated that an extension option entitles the optionee to extend the lease on the terms and conditions of the original lease and its exercise automatically extends the term without requiring the execution of a new lease. By contrast, a lease renewal envisions the execution of a new lease. It would have been helpful for the court to indicate whether Maryland recognizes a difference between these terms.

The *Chesapeake Bank* court referred to a 1954 Court of Appeals case that stated in dicta that it is unnecessary to state in an option that time is of the essence. For that reason, the *Chesapeake Bank* court apparently saw no need to indicate whether the lease here contained a time of the essence provision.

This case underscores the importance of making sure that tenant clients have a system to track notice deadlines in their leases. Tenants with a number of properties have computer tracking systems to assist them in this effort. But, as shown here, these systems are not infallible, and an inadvertent entry of an incorrect time period will lead to the relinquishment of a valuable contract right.

Conclusion

Chesapeake Bank establishes a rule that does not admit of equivocation or flexibility. Missing a lease extension deadline by one day is just as fatal as missing it by 27 days or three months, and the resulting hardship to the tenant is immaterial. It’s unclear whether *Monro* will seek review by the Maryland Court of Appeals, but until then tenants need to heed the teachings of the inflexible rule of lease extension notice deadlines articulated by the *Chesapeake Bank* court

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