ABA SECTION OF REAL PROPERTY, PROBATE AND TRUST LAW
RPPT eREPORT
NEWS, PRACTICE UPDATES AND MEMBER BENEFITS

## Articles

Contractual Deadlines for the Exercise of Options: Do They Mean What They Say?

By John C. Murray

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In a recent decision, *Metro Dev. Group, L.L.C. v. 3D-C & C, Inc.*, 941 So. 2d 11 (Fla. Dist. Ct. App. 2d Dist. 2006), the Florida Appellate Court affirmed the decision of the trial court that an option contract requiring that an option extension payment by made on a Saturday, should be interpreted so that an extension payment made on the following Monday (the first business day after the day provided for in the option agreement) would be ineffective and would terminate the rights of the option holder.

The option contract provided that if Metro Development Group, L.L.C. ("Optionee") chose not to terminate the option contract, it was required to make an additional escrow deposit of $ 20,000 and a payment of either $ 119,000 or $ 29,575 to 3D-C & C, Inc. ("Optionor") to extend the option, depending on the length of the extension that the Optionee desired. The option contract required that an additional escrow deposit and extension payment be made on or before the forty-fifth day after its effective date. The contract also provided that "[a]t any time when these payments are not made within the time described, the purchaser[']s rights under this contract will terminate [and the] obligations of the seller to the [p]urchaser shall terminate." Another paragraph in the contract simply referred to the "45 th" day and made no reference to "business days." In fact, the only reference to "business days" in the contract was contained in a provision that extended the time for the Optionee's inspection of the property "until the expiration of five (5) business days from the date cured or waived by the Purchasers, whichever last occurs." The contract further contained a provision that "time is of the essence of this agreement."

The appellate court determined that August 18, 2004, was the effective date of the option contract, and that the 45 th day after that date was Saturday, October 2, 2004. On Friday, October 1, 2004, the Optionee paid an additional escrow deposit of $20,000 but failed to make the required extension payment, in the amount of $29,575, until the following Monday, October 4, 2004. The Optionor rejected this payment as untimely and insufficient to extend the option, which it deemed terminated. The escrow agent filed an interpleader action to resolve this issue, and the Optionee filed a cross-claim seeking specific performance of the agreement or, alternatively, for damages for breach of contract. The Optionor filed a motion to dismiss and for summary judgment, arguing that the option had expired because the Optionee had failed to timely make the required extension payment. The Optionee argued that a "latent ambiguity" existed because the parties had failed to address the specific situation of what would happen if the extension fell on a Saturday, Sunday, or holiday. The Optionee also claimed that the court should look to "custom and usage" in the real estate industry and the conduct of the parties, "both of which indicated that payment should be made on the *next business day* after the deadline." *Id.* at 13 (emphasis in text).

The court granted summary judgment for the Optionor, ruling that the contract was clear on its face and that no latent ambiguity existed. The court refused to consider any parol evidence to ascertain the parties' intent because it found that paragraph 3 of the contract was clear and unambiguous, i.e., that the payment extension must be paid on or before the forty-fifth day after the date of the initial contract as it simply referred to "the 45 th day" and made no reference to "business days." According to the court, "[t]he circumstance that the forty-fifth day after the effective date of the contract might fall on a weekend or holiday is a circumstance that is obvious." *Id.* at 14. The court therefore reasoned that the Optionee's claim that a latent ambiguity existed under the circumstances in this case "borders on the nonsensical." *Id.* The court noted that this was highlighted by the fact that the only provision in the contract that referred to "business days" specifically extended the inspection period "until five business days after the cure or waiver of title defects. The inclusion of that provision demonstrates that the parties were well aware of the difference between 'days' and 'business days.'" *Id.* The court also held that the Optionee's reliance on purported "custom and usage" in the real estate industry was unavailing, because the parties to such agreements are free to contract as they choose, and often agree that the time for performance will be extended when the final date for performance would fall on a Saturday, Sunday, or holiday; in this case, the parties decided not to provide for such an extension. In addition, the contract contained a clear "time is of the essence" provision, and the court found that there was "no reason to believe this provision was not intended to apply to the obligation to make payments for extending the option." *Id.* The court simply refused to "rewrite the agreement of the parties or alter the obligation for timely performance to which [the Optionee] unequivocally agreed." *Id*.

The court cited and quoted approvingly from an earlier Florida decision, *C.W. Kistler Co. v Hotel*

*Martinique, Inc*., 44 So. 2d 288, 291, (Fla. Dist. Ct. App. 2d Dist.), which held that “where a stipulated time is mentioned in an option contract, it becomes the essence of the contract, which must be performed within the time mentioned.” *See also Brick Plaza, Inc. v. Humble Oil & Refining Co.*, 218 N.J. Super. 101 (App. Div. 1987). In this case the optionee requested that the court allow it to exercise an expired option to purchase land it had leased from the optionor, asserting that its failure to exercise the option to purchase was an honest mistake on its part. The court affirmed the lower court’s grant of summary judgment in favor of the optionor because the optionee’s delay was not slight and it had committed positive neglect when it did not exercise its option in a timely fashion. The court found that the clearly fixed obligations of the optionee had been so grossly breached that the court's interest in preserving the stability of business arrangements outweighed whatever equitable purpose may have been served if the optionee had been relieved from the consequences of its own neglect. (The *Brick* case also sets forth in detail “the cases in which equity has intervened to mitigate the hardship resulting from a tenant’s failure to give timely notice where it is found that the tenant’s delay was ‘slight,’ where it did not prejudice the landlord and where failure to grant relief would cause the tenant unconscionable hardship” *Id.* at 104). The court in the *Brick* case noted that the delay extended almost five and a half months beyond the expiration of the three-month period limited for the giving of notice. The court stated that “The maxim has long been recognized that equity aids the vigilant, not those who sleep on their rights.” *Id.* at 104 (citation omitted).

Many of these types of cases (i.e., those dealing with the issue of whether an exercise of an option is timely made) are fact-specific, and courts will often apply equitable principles to prevent what they may deem to be an unjust result. (But in these days of sophisticated computer programs with automatic tickler and follow-up features, the parties should be vigilant and strive to meet the option and other deadlines expressed in leases and other real-estate contracts.) *See, e.g.,Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Assocs.*, 182 N.J. 210 (N.J. 2005). In this case, the lessee-plaintiff sought to exercise a lease option that allowed for a 99-year renewal, and notified the landlord-defendant of its intention to do so on numerous occasions but without realizing that it had failed to meet all requirements for valid exercise. Despite knowing of the plaintiff's stated intention to exercise the lease option, "defendant, through its agents, engaged in a pattern of evasion, sidestepping every request by plaintiff to discuss the option and ignoring plaintiff's repeated written and verbal entreaties to move forward on closing the ninety-nine year lease." *Id.* at 229. The Supreme Court of New Jersey explained that the lessee-defendant's receipt of plaintiff's repeated letters and telephone calls concerning the exercise of the option obliged the lessee-defendant to respond and to respond truthfully. Despite the court's reluctance to interfere in commercial relationships between knowledgeable parties, it found the landlord's subterfuges and evasions so clearly indicative of bad faith that under the circumstances of the case the tenant had shown breach of the covenant of good faith and fair dealing, so that a grant of equitable relief was appropriate because of the lessor-defendant’s “demonstrable course of conduct, a series of evasions and delays, that lulled plaintiff into believing it had exercised the lease option properly." *Id.* at 230-31. (The *Brunswick* case contains a lengthy and comprehensive discussion of what constitutes a breach of the implied covenant of good faith and fair dealing in connection with a commercial lease dispute). *See alsoPitkin Seafood, Inc. v. Pitrock Realty Corp.*, 536 N.Y.S. 2d 527 *(* N.Y. App. Div. 2d Dep't 1989*)*, where the court permitted the late exercise of an option where there was a likely loss of investment and the optionor was not harmed. According to the court:

Even if [the optionee’s] initial exercise of the option was not proper, the subsequent attempt by [the assignee of the lessee's interest in the lease] should be given effect. Although it is a settled principle of law that a notice exercising an option is ineffective if not given within the time specified (citations omitted), it is further recognized that a tenant's equitable interest is protected against forfeiture where the tenant has in good faith made improvements, if the landlord has not been harmed by the delay. The Court of Appeals has held that a tenant is equitably entitled to the benefit of the rule which relieves against such forfeitures of valuable lease terms, when default in notice did not prejudice the landlord, and resulted from an honest mistake, or similar excusable default (citations omitted).

*Id.* at 619; *P.L.I. Dev., Inc. v. Fetterman*, 293 A.D. 2d 657, 658 (N.Y. App. Div. 2002) ("given the plaintiff's large expenditures on the property, the lack of prejudice to the defendants if the option is given effect, and the honest mistake which led to the plaintiff's short delay in exercising its option, equity compels specific performance of the option"); *Weissman v. Adler,* 187 A.D.2d 647, 647 ( N.Y. App. Div. 2d Dep't 1992) (holding that claims by the tenant that he has made substantial improvements to property during his tenancy and that he has established goodwill during the years he conducted his business at that location, if proven, would entitle the tenant to enforce an option agreement provided that the landlord fails to demonstrate prejudice); *Unique Marble & Granite Org. Corp. v. Hamil Stratten Props.*, LLC, 2006 N.Y. Slip Op. 52174U (3 N.Y. Misc. 2006) at *3 ("the option was timely exercised and signed by the president of the corporate tenant, John Manasakis, who is and remains in possession of the premises. There is no evidence that Manasakis intended to exercise the option in his individual capacity. The failure to change the name of the tenant from John Manasakis to Unique Marble & Granite Org. Corp., as amended by hand on the lease, and the failure to insert the name of the corporation before his signature is an insignificant defect and may be the product of negligence or mistake rather than an attempt to modify or undermine the agreement of the parties"); *In re Royal Yarn Dyeing Corp.*, 114 B.R. 852, 862 (Bankr. D.N.Y. 1990) ("In the instant case, there is ample support on equitable grounds for protecting the Debtor from the forfeiture that would result if it were held to the letter of the lease agreement and the deadline for exercising the renewal option. The testimony taken before this Court and the record is replete with evidence that Royal Yarn has made substantial improvements to the premises over the life of its tenancy").

*Cf. Comerica Bank v. Harbor Northwestern-38000,* 2003 Mich. App. LEXIS 3042 ( Mich. Ct. App. Dec. 2, 2003). In this case, it was undisputed that the optionee did not exercise its option to renew the lease within the time period specified (April 30, 1999) because it was trying to renegotiate the rent. Such notice was not in fact given by the tenant until June 11, 1999. The court held that the optionor could have refused to renew the lease and the optionee would have lost all interest in the premises when the lease term ended on October 31, 1999. But the optionor instead accepted the optionee's late offer to renew for a five-year term ending October 31, 2004. The court ruled that the parties' rights and obligations during the renewal term were the same as in the original lease except as otherwise provided. The renewal agreement did not expressly delete or modify the option clause in the original lease and therefore, the court held that the optionee had one more option to renew.

See also Market Street Assoc. v. Frey , 21 F.3d 782 (7 th Cir. 1994). In this case (which arose out of a sale-leaseback transaction), the contract provided that if the lessee wished to improve the property, it was first required to ask the lessor to provide the needed financing. In particular, the contract contained a provision (paragraph 34) stating that the lessor agreed "to give reasonable consideration to providing the financing of such additional Improvements and Lessor and Lessee shall negotiate in good faith concerning the construction of Improvements and the financing by Lessor of Improvements and the financing by Lessor of such costs and expenses." Id . at 784. If, after negotiations, the lessor declined to provide any such financing of additional improvements, the lessee was then authorized to purchase the property at a price determined by a specific formula set forth in paragraph 34 of the contract. In 1988 the parties negotiated over the financing of improvements on, or a possible sale of, one of the four properties covered by the contract. They did not reach an agreement, and the lessee filed suit for specific performance to force the sale of the property to it pursuant to the contractual formula. If specific performance were granted, the tenant would be able to buy the property at a discounted price, due to appreciation in values in the unexpectedly long time that had run before the tenant asked for the financing. But the court held that because of the tenant's deliberate intention "to deceive the [landlord] through a series of vague and ambiguous letters," the tenant had "violated its duty of good faith and fair dealing in performance of the contract." Id. at 788. The court found that by deliberately failing to make specific mention of paragraph 34 of the contract in any of the relevant correspondence and conversations that occurred between the parties in 1988, and knowing that the landlord "was not operating under paragraph 34," Id. at 787, "[the tenant] did not bring this matter to the [landlord's] attention, and continued to write ambiguous letters, until he wished to utilize the purchase option, thereby purchasing the property at a discounted cost." Id. Thus, the court held, the tenant had breached its duty of good faith and fair dealing and "intended to trick the [landlord] by implementing a plan designed to acquire a valuable piece of real property at a price substantially below its market value." Id. Because the landlord had breached its duty of good faith and fair dealing in the performance of the contract and took advantage of the tenant's "unilateral, inadvertent mistake regarding financing opportunities," the court refused to award specific performance to the landlord. Id . at 788. See generally , George A. Locke, Annot., Timeliness of Notice of Exercise of Option to Purchase Realty , 87 A.L.R.3d 805, supp. sec. 3.

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## Article

# A COMMENTARY ON 'FLIP TAXES'

***Jasleen K. Anand, Esq.***

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A flip tax is a fee imposed upon the seller/assignor of a cooperative unit when the shareholder transfers the unit to a purchaser. This fee allows the cooperative corporations to increase their reserve funds to make current or future improvements in the building and to avoid boosting the maintenance fee.

There is wide disparity among various corporations of using methods to compute this flip tax, depending upon the way prescribed in the governing documents of the corporation. As a result, no two corporations require the same amount of tax in dollars and cents. Some cooperative corporations base the flip tax on the number of shares actually being sold and accord a dollar value to each share. Others favor a flat fee method by charging the same fee to all assignors, regardless of the size of the unit being transferred. Some calculate flip tax as a percentage of the gross sale price, while others calculate it as a percentage of net profit. Still others combine all of these methods.

**BACKGROUND OF DECISIONAL AND STATUTORY LAW**

In the 1985 case of *Fe Bland v. Two Trees Management Co., et al., 330 West End Apartment Corporation v. Kelly,* 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S. 2d 336 (1985), the New York Court of Appeals grappled with the issue of whether the imposition of the tax violated the corporation's proprietary lease and whether the flip tax should be returned to the shareholder. The lower court ruled it did violate the proprietary lease and had to be returned. The appellate court held that where the bylaws of the corporation provided that the board may impose "only a reasonable fee to cover actual expenses and attorneys' fees of the Corporation, a service fee of the Corporation and such other conditions as it may determine", the board may not charge flip tax. The court had reasoned that the term "other conditions" could not be construed to give the authority to the board to charge a flip tax and, to do so, would have meant reading the sentence fragment out of context and contrary to the rule of construction.

The court also ruled that flip tax may not be charged where such tax "was not in proportion to the shares held". The proprietary lease here had provisions such as a "cash requirements" provision. Under the cash requirements provision, the lease provided:

" '[cash] requirements' whenever used" means the amount necessary for operation and improvement of the property, contingency reserves and the payment of liabilities and expenses after giving consideration to income expected and cash on hand....The form and provisions of all the proprietary leases then in effect and thereafter to be executed may be changed by the approval of lessees owning at least 75% of the Lessor's shares then issued, and such changes shall be binding on all lessees even if they did not vote for such changes, except that the proportionate share of rent or cash requirements payable by any lessee may not be increased…without his express consent.

The court found the flip tax not to be "proportional to the number of shares held by that shareholder in relation to total number of issued shares" and it was "not approved by 75% of the shareholders".

The court's reasoning was also based upon a close reading and understanding of the statute, Business Corporations Law § 501 (c), which stated then in its entirety: "Subject to the designations, relative rights, preferences and limitations applicable to separate series and except as otherwise permitted by subparagraph two of paragraph (a) of section five hundred five of this article, each share shall be equal to every other share of the same class." In this matter, the board of directors had passed a resolution to amend the bylaws to assert that upon assignment, the board shall impose a transfer fee in varying amounts from $50 per share to $200 per share, depending upon whether the seller had purchased the unit from a sponsor or from a non-sponsor and whether the assignor had owned the unit for greater than five years. The court stated that the legislature meant for the shares of the same class to be treated equal in all respects to every other share of the class and, therefore, the flip tax was illegally imposed upon the assignor.

**AFTERMATH OF DECISIONAL LAW**

It was in 1985 that the *Fe Bland* case was decided. It stirred a pandemonium in the cooperative corporation industry and caused cooperative corporations to raise a united voice in the legislature. As a result, the New York State Legislature amended the Section 501 (c) of the Business Corporation Law by enacting the Chapter 598 of the Laws of 1986. The amendment authorized the corporations to charge the flip tax not only on the basis of a per share but also on the basis of other methodologies used by cooperative corporations, but "only if the cooperative's maintenance charges, general assessments pursuant to a proprietary lease, and voting, liquidation or other distribution rights are substantially equal per share".

Then a decade later, on or about March 1996, the Legislative Assembly revisited the issue of flip taxes and pointed out that previous amendment did not resolve all the outstanding problems for generally all the cooperative corporations, specifically ones that provided in their organizational documents that "every shareholder shall have only vote regardless of the number of shares held". The Assembly determined that variable formulas that take into account the sale price, profit, holding period or other criteria, retained by various corporations render fairer results than a fixed formula and amended the statute accordingly.

Thus in the final analysis, the statute, having gone through a metamorphosis, reads:

With respect to corporations...on a cooperative basis, however, provided that (2) changes in maintenance charges and general assessments…have been and are hereafter fixed and determined on an equal per share basis or an equal per room basis or as an equal percentage of the maintenance charges, and (3) voting rights are substantially equal per share or the certificate of incorporation provides that the shareholders holding the shares allocated to each apartment or dwelling unit owned by the corporation shall be entitled to one vote in the aggregate regardless of the number of shares allocated to the apartment or dwelling unit or the number of shareholders holding such shares, shares of the same class shall not be considered unequal because of variations in fees or charges payable to the corporation upon sale or transfer of shares and appurtenant proprietary leases that...or properly approved amendments to the foregoing instruments.

It is nice that the cooperative corporations were able to have it their way at the end and their sacred "business judgment rule" was sheltered, but what about the prospective purchasers who are denied loans or whose loan amounts are reduced by the amount of flip tax? The market ought to have some responsibility towards the purchasers who have immaculate credit history and meet all criteria of the cooperative board, in terms of financing contingencies and limitations, but unfortunately cannot purchase the unit because the lenders' underwriting guidelines (prescribed by Fannie Mae) provide that buildings that impose flip taxes will be eligible if the flip tax is generally no greater than 3% of the sales price. *State of New York Mortgage Agency Low Interest Rate Program-Credit and Property Underwriting Requirements-Cooperative Share Loans* provides that, “Loans in cooperative with flip taxes will generally be handled by reducing the sales price of the cooperative unit by the amount of the flip tax. The loan amount will be based on 90 percent of the computed sales price.”

Buildings that charge a lofty flip tax undoubtedly put a burden on the market, on the potential purchasers, on lenders, on lenders’ underwriters and even on sellers/assignors of the units. Assignors who choose to sell/assign their units shortly after purchasing them, feel the pressure of paying the high flip tax, especially since they were truly never the recipients of any and all benefits, if any, that flowed from the charge of the flip tax. In this circumstance and many other related ones then, the flip tax causes an unreasonable restraint of an owner’s right to transfer his or her property. A high flip tax also discourages investors from purchasing cooperative units. Cooperative corporations that base their calculation of flip taxes on the amount of seller’s profit invite collusion between sellers and buyers to refrain from declaring the entire sale price.

New legislation ought to be enacted which addresses the needs of both the assignors as well as and most importantly, the prospective purchasers. Perhaps legislation should address the possibility of not charging a flip tax to assignors who plan to move to another unit within the same building. The legislature’s thought, that variable flip tax renders more equitable results than a fixed formula, is I believe entirely true for cooperative corporations, but not necessarily so for assignors/sellers and the prospective purchasers, especially if the cooperative board of the cooperative corporation amends the governing documents to the surprise of the assignors.

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## Module Title

# CUSTOMARY PRACTICE IN GIVING AND RECEIVING LEGAL OPINIONS

*By Stirling Scott Willis*

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There have been important recent national developments in connection with the rendering and receipt of third party legal opinions. In October 2006, an invitation only seminar was jointly sponsored by the American Bar Association, the TriBar Opinions Committee, and the legal opinion committees of several major commercial states and law firms. The Legal Opinion Risk Seminar (“LORS”) focused on various aspects and risks related to the giving and receiving of opinions, and whether there is agreement as to the customary practice with respect to legal opinions, and how customary practice affects legal opinion risks.

The LORS was attended by numerous in-house counsel, representatives from lawyer liability insurers, rating agencies, and, the current chair and several prior chairs of the Legal Opinions Committee of the Real Property, Probate and Trust Section. A second meeting of LORS is scheduled for April 2007.

In addition to litigation issues regarding the giving and receipt of legal opinions, the LORS project is focusing on various issues related to the responsibility and concerns of opinion givers, recipients and their counsel, the assignability of opinions, who may rely on opinions, the customary practice in giving and receiving legal opinions, and whether customary practices and the meaning of specific opinion words differ depending on the size of a law firm, whether the opinion receiver is sophisticated or unsophisticated, if in-house counsel are involved, or other factions.

The ABA Business Law Section's *Legal Opinion Principles* provide that "the matters usually addressed in opinion letters, the meaning of the language normally used, and the scope and nature of the work counsel is expected to perform are based (whether or not so stated) on the customary practices of lawyers who regularly give and lawyers who regularly advise opinion recipients, regarding the opinions of the kind involved. 53 Bus. Law 831 (1998). Our Section, in adopting the *Real Estate Opinion Guidelines* accepted this definition of the standard of customary practice with respect to interpretation of legal opinions. 38 Real Prop. Prob. & TR. J. 241 (2003).

While all major bar groups have endorsed the use of customary practice, debate exists whether customary practice is understood throughout the country by opinion givers and recipients. Also, it is not clear as to what sets the benchmark for determining customary practice; is it the TriBar reports, state and local committee reports, national real estate reports , or other sources.

The Opinions Committee of the Real Property, Probate and Trust Section has formed an ad hoc committee to work in tandem with the LORS project to try to explore the convergences and divergences between customary real estate legal opinion practice and customary corporate (non-real estate) legal opinion practice.

Please review the RPPT Legal Opinions Committee webpage at http://www.abanet.org/dch/committee.cfm?com=RP213000 for more information on our section's efforts with respect to legal opinions issues and for links to various legal opinion resources and publications. There is also a link on the RPPT Legal Opinions Committee webpage to the Legal Opinion Resource Center co-sponsored by the ABA Business Law Section and the Tribar Opinions Committee