



The “Charming Head” of the Rule Against Perpetuities

By David H. Fishman and Edward J. Levin

The September/October 2017 issue of *Probate & Property* contained an extensive article regarding purchase options and rights of first refusal. Kathryn E. Allan et al., *Rethinking Rights of First Refusal, Rights of First Offer, and Options to Purchase*, Prob. & Prop., Sept./Oct. 2017, at 48. The article commented that, regarding purchase

David H. Fishman and Edward J. Levin are members of Gordon Feinblatt LLC in Baltimore, Maryland. Ed Levin is past chair of the Section’s Real Estate Finance Group.

options, the Rule Against Perpetuities can “rear its charming head regularly, albeit sometimes in useless desperation.” This occurs in cases with purchase options under commercial leases where the purchase price in the option clause may bear no relation to current market value of the property.

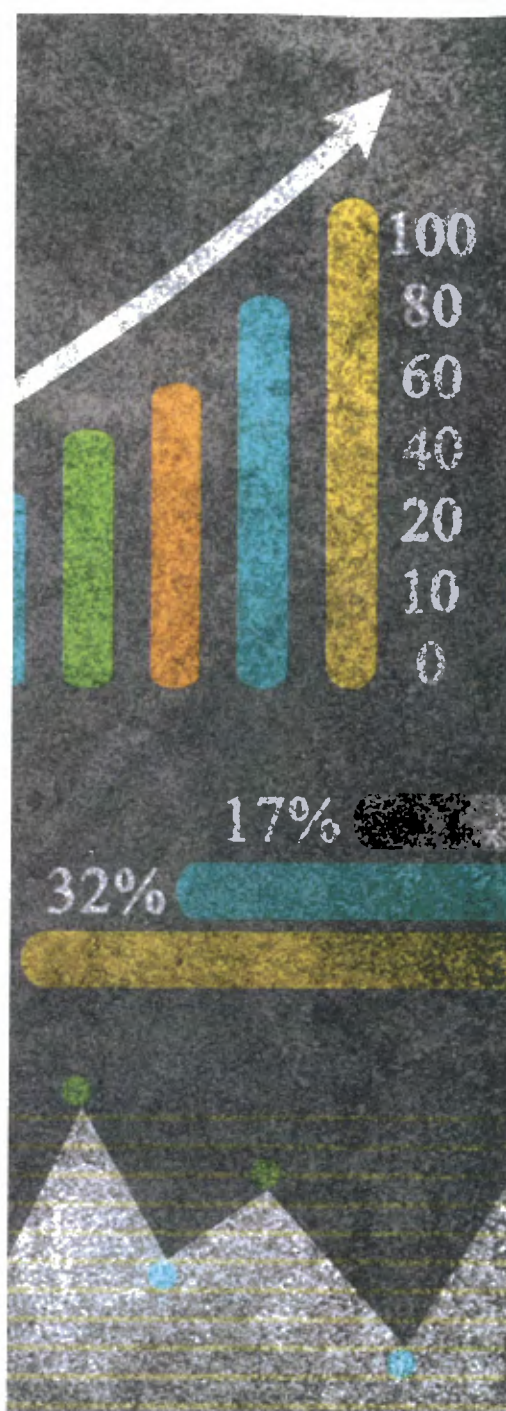
Maryland Lease Purchase Option Case

A recent case in Maryland illustrates this situation. *PMIG 1028, LLC v. Nw. Plaza Assoc., LLLP*, in the Circuit Court for Baltimore County,

Maryland, Case No. 003-C-16004173. The case involved a gas station lease from 1975 that contained renewal options ending in 2016. The lease included a purchase option in favor of the tenant with a purchase price that was reasonable in 1975, but it was about one-third of the 2016 market value of the property. The tenant renewed the lease through 2016, and near the end of the lease term sent notice of exercise of the purchase option.

The landlord took the position that the purchase option, which stated

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claim the benefit of the new law.

These facts set up some interesting legal arguments. As background, the Rule Against Perpetuities was recently dealt with extensively in an article in the *Real Property, Probate, and Trust Journal*. Frederick R. Schneider, *Rule Against Perpetuities for the Twenty-First Century*, 41 *Real Prop. Prob. & Tr. J.* 743 (2007). Under the common law Rule Against Perpetuities, if an interest is not certain to vest within 21 years after some designated life in being at the time of the creation of the interest, it is void.

The 1975 lease being litigated contained some very helpful language for the landlord. Not only did the purchase option state that it could be exercised “at any time” after the original term of the lease but also contained a right of first refusal that stated it could be exercised, if at all, only “during the lease term.” Given the differences in the language affecting these rights, a strong argument was made that the drafters of the lease intentionally made the purchase option open-ended and exercisable at any time in the future. Motions for summary judgment were filed and argued, with the tenant contending that the renewal of the lease in 2011, after the 2007 reform of the Rule in Maryland, meant that the purchase option, if originally void, was revived at the time of lease renewal. The landlord, on the other hand, argued that under all rulings about the Rule prior

to 2007, an open-ended purchase option that could be exercised at any time in the future was void ab initio and therefore did not exist, and could not be revived, at the time of renewal in 2011.

The Restatement of Property states expressly that purchase options in leases are exempt from the Rule Against Perpetuities. The applicable Restatement section provides as follows:

When a lease limits in favor of the lessee an option exercisable at a time not more remote than the end of the lessee’s term

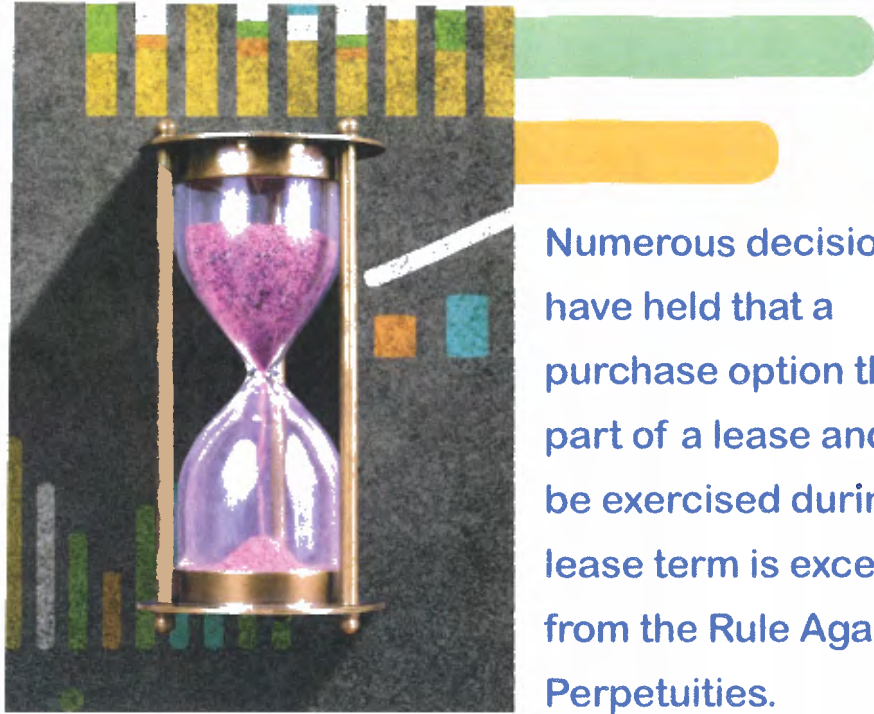
(a) to purchase the whole or any part of the leased premises; or

(b) to obtain a new lease or an extension of his former lease,

then such option is effective, in accordance with the terms of the limitation, even when it may continue for longer than the maximum period described in §374 [Permissible Period under Rule Against Perpetuities].

Restatement (First) of Property § 395(a) (Am. Law Inst. 1944) (emphasis added). Comment (b) to Restatement section 395 gives a specific explanation to the exception that is particularly applicable to this

that it could be exercised “at any time” after the original 20-year term of the lease, was void ab initio as a violation of the version of the Rule Against Perpetuities in force in Maryland when the lease was signed. The tenant countered that it had renewed the lease as recently as 2011, which created a new agreement, thereby containing a newly created purchase option. Of importance, in 2007 Maryland had reformed its Rule Against Perpetuities to state that it was no longer applicable to commercial transactions. The tenant wanted to



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situation. It provides:

Under the rule stated in this Section the option must be “exercisable at a time not more remote than the end of the lessee’s term.” Under this restriction the option may be exercisable either at the end of the lessee’s term, or during its continuance, or subsequent to the execution of the lease containing the option but prior to the commencement of the possession of the leased premises thereunder.

In order to have the rule stated in this Section apply it is essential that the option be, under no circumstances, exercisable after the end of the lessee’s term. If that term ends in any way prior to the end of the stipulated number of years, as for example, by forfeiture, the option must then also end. Any limitation which purports to create an option to last for longer than the maximum period described in § 374 and after the end of the lessee’s estate, invalidates the option ab initio.

Id. cmt. b (emphasis added). Therefore, the Restatement section 395(a) exemption applies only if the

purchase option must be exercised, if at all, during the term of the lease. If the option may be exercised beyond the term of the lease, then the exception provided by Restatement section 395(a) does not apply.

In granting summary judgment for the landlord, the trial court ruled that the option that stated that it was exercisable “at any time” could be exercised even after the term of the lease had expired and therefore was void ab initio. The option was not entitled to the benefit of the Restatement rule because from its face it was exercisable after the term of the lease. This ruling was reinforced by the fact that the right of first refusal in the lease was limited to being exercised only during the term of the lease. Additionally, the court held that the 2007 legislation did not apply retroactively to the 1975 lease.

Maryland appellate courts had never decided whether a purchase option in a lease is subject to the common law Rule Against Perpetuities. Like New York, the highest court in Maryland is called the Court of Appeals. In two cases, the Maryland Court of Appeals stated that there were limited exceptions to the Rule Against Perpetuities, and that among the exceptions were purchase options contained in leases. The Court of Appeals did not point out that this

exception has been generally limited to situations where the option is exercisable only during the term of the lease, as is clearly set forth in Restatement section 395(a) and its comments. Therefore, the landlord faced the challenge of convincing the trial court that the language used by the Court of Appeals was incomplete and was provided for purposes of illustration only.

Courts in a number of other states and federal jurisdictions applying state law (as recently as 2014) have stated, in accordance with Restatement section 395(a), that a purchase option that may be exercised after the end of the lease term violates the Rule Against Perpetuities. E.g., *Ezer v. Texas Tower Ltd.*, No. H-13-1805, 2014 WL 3669222, at *6 (S.D. Tex. July 22, 2014) (adopting Restatement §395(a) in its entirety to the Texas Rule Against Perpetuities); *Getty Realty Corp. v. Hettler*, No. 97-5637, 1998 WL 76308, at *2 (E.D. Pa. Feb. 23, 1998), aff’d, 172 F.3d 40 (3d Cir. 1998) (recognizing adoption of Restatement §395(a) by Pennsylvania courts); *Texaco Ref. & Mktg., Inc. v. Samowitz*, 213 Conn. 676, 685 (1990) (stating that this position “is consistent with the weight of authority in the United States”).

Similarly, numerous decisions have held that a purchase option that is part of a lease and must be exercised during the lease term (an “appurtenant” option) is excepted from the Rule Against Perpetuities. E.g., *Symphony Space, Inc. v. Pergola Properties, Inc.*, 88 N.Y.2d 466, 480 (1996) (stating “an option to purchase land that originates in one of the lease provisions, is not exercisable after lease expiration, and is incapable of separation from the lease” is excepted from the Rule); *Citgo Petroleum Corp. v. Hopper*, 245 Va. 363, 366 (1993) (same, and citing other jurisdictions adopting this position).

Rule Against Unreasonable Restraints on Alienation

Many purchase options contained in leases that violate the Rule Against Perpetuities also violate the Rule Against Unreasonable Restraints on

Alienation. That rule voids interests that last too long. E.g., *Metro. Transp. Auth. v. Bruken Realty Corp.*, 492 N.E. 2d 379, 383 (N.Y. 1986). The Rule Against Perpetuities, in contrast, voids interests that do not vest soon enough. However, a fixed-price purchase option that could be exercised years and years from the time it was created is a textbook example of an interest that lasts too long. In the Maryland case, the trial court did not address the issue of whether the purchase option violated the Rule Against Unreasonable Restraints on Alienation because it ruled for the landlord based on the violation of the Rule Against Perpetuities. The writers believe that had the issue been considered, the purchase option would have been declared void for violating the Rule Against Unreasonable Restraints on Alienation as well.

The policy reason for both rules is that an interest such as a purchase option for a fixed price takes the affected property “out of commerce.” While the purchase option is outstanding, the owner or tenant of the property has no incentive to improve the property because a third party can buy it for an already established price.

The tenant in the PMIG 1028 case appealed the circuit court’s decision to the intermediate appellate court in Maryland. After the parties filed briefs with the appellate court, they reached a settlement. Therefore, there will not be an appellate decision in this case.

Uniform Statutory Rule Against Perpetuities

The result in this case would have been different had the lease in PMIG 1028 been for property in a state that, unlike Maryland, has adopted the Uniform Statutory Rule Against Perpetuities (USRAP) and had been signed after the effective date of USRAP. At this time, according to the Uniform Law Commission, 28 states, the District of Columbia, and the U.S. Virgin Islands have enacted USRAP. See Unif. Law Comm’n, Legislative Fact Sheet – Statutory Rule Against Perpetuities (2018), <http://www.uniformlaws.org/Legislative-FactSheet.aspx?title=Statutory%20Rule%20Against%20Perpetuities>.

The case at issue was decided under the common law Rule Against Perpetuities, which is applied based on the facts existing at the time of creation of a nonvested property interest. On the other hand, USRAP generally adopts a wait-and-see approach. Section 1(a)(2) of USRAP provides that a nonvested property interest is not invalid if it actually vests or terminates within 90 years after it is created. See Unif. Statutory Rule Against Perpetuities § 1(a)(2) (Nat’l Conference of Comm’ns on Unif. State Laws 1990), http://www.uniformlaws.org/shared/docs/statutory%20rule%20against%20perpetuities/USRAP_2011_Final%20Act_2014sep11.pdf. USRAP, however, excepts nonvested property interests arising out of a nondonative transfer. Id. § 4. The comment to section 4 explains that exempting nondonative nonvested interests and powers of appointment from coverage under USRAP is contrary to common law and inconsistent with a number of state court decisions but justifies

the change by noting that the Rule Against Perpetuities is a “wholly inappropriate” instrument of social policy to use in relation to nondonative transfers. In PMIG 1028 the option was in connection with a commercial lease, clearly a nondonative transfer, and so it would be exempt from USRAP.

Also, the Restatement (3rd) Property § 27.3 (2011) has a blanket exemption from the Rule Against Perpetuities for all commercial transactions. Had this restatement provision controlled, the subject case would have been decided differently. However, the 2018 pocket part to this restatement provision does not show any state adopting that section.

Conclusion

The recent Maryland case discussed in this article indeed is a situation where the Rule Against Perpetuities “reared its charming head” but, from the view of the landlord, not in desperation. ■

A fixed-price purchase option that could be exercised years and years from the time it was created is a textbook example of an interest that lasts too long.

