

**Commercial Tenants May Extend Their Lease Terms
Even When Late in Exercising Options to Extend -
In the Right Circumstances**

Many commercial leases grant tenants options to renew or extend the terms of their leases. Typically, the leases require the tenants to exercise their extension options by a certain date, often six to nine months before the current lease term is to expire. If a tenant fails to timely exercise the extension option, its option will expire and no longer be valid. These leases state that "time is of the essence," meaning a tenant failing to exercise its option by the designated date cannot extend the lease term unless the landlord will accept a late exercise of a renewal option.

Courts have typically enforced these provisions if a tenant was late in exercising its extension option and the landlord was unwilling to forgive or waive the late exercise of the option. However, it has been the law of our state for more than 30 years that in certain circumstances, a tenant that exercises its option late may nonetheless successfully extend the term of its lease. A recent Court of Appeals case has reaffirmed this concept.

A 1979 case held that a trial court could, at its discretion, grant a tenant an equitable grace period, allowing the tenant to exercise its renewal option late, if five specific conditions were satisfied:

- (1) The failure to timely exercise the notice was purely inadvertent;
- (2) An inequitable forfeiture of the tenant's investment in the premises would result if the late exercise of notice was not honored;
- (3) As a result of the tenant's failure to give timely notice, the landlord did not change its position in any way and was not prejudiced;
- (4) The lease was for a long term rather than a short term; and
- (5) There was no undue delay in the giving of the notice by the tenant.

The courts seem to consider the second point - the tenant's investment in the leased premises - to be critical.

This concept was recently reaffirmed in a case involving World Wrapps' restaurant at the REI flagship in downtown Seattle. In the *REI* case, the parties had amended the lease and inadvertently inserted an incorrect date by which World Wrapps needed to exercise its option. Neither party caught the mistake. World Wrapps failed to give its notice by the date specified in the lease amendment but did give timely notice in compliance with the original lease. However, REI refused to accept World Wrapp's attempt to exercise the renewal option.

The court found all five of the conditions stated above were satisfied and granted World Wrapps an equitable grace period in which it could exercise the extension option. The court placed great emphasis on the fact that World Wrapps had committed approximately \$250,000 to

upgrade the leased premises in reliance upon its extension of the lease. The court found it would be an unfair forfeiture of World Wrapps' investment if REI were allowed to terminate the lease.

The lesson for commercial tenants? Ensure all renewal dates are properly noted and calendared so they may be timely exercised. However, landlords should be aware that a tenant's late exercise of its extension option does not automatically mean the lease will expire at the end of its current term. The landlord should review the situation in light of the five factors identified by the courts, with a specific focus on the nature and extent of the tenant's investment in the property. If the renewal notice was inadvertently late and the landlord has not changed its position in reliance upon the anticipated termination of the lease, a court is likely to allow a late exercise of the extension option IF the tenant has made a substantial investment in the property.

Landlords should recognize this exception to the "time-is-of-the-essence" provision and deal with the tenant in a fair and reasonable manner rather than taking a hard-nosed position that the tenant has forfeited its extension rights. Given the right circumstances, a court may rule otherwise. If the lease contains an attorneys' fees provision, the landlord may end up paying the tenant its attorneys' fees, costs and expenses incurred in establishing its renewal right.