

135 E. 57th St. LLC v Daffy's Inc.

2010 NY Slip Op 33751(U)

October 13, 2010

Sup Ct, NY County

Docket Number: 101857/10

Judge: James A. Yates

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 49

-----X

135 EAST 57TH STREET LLC,

Index No. 101857/10

Plaintiff, :

Verdict, Judgment and

- against - :

Decision After Non-

Jury Trial

DAFFY'S INC, :

Defendant. :

-----X

Hon. James A. Yates, J.S.C.

This case involves the narrow issue of whether a tenant's late notice of its intention to renew a commercial property lease should be excused on equitable grounds. Plaintiff, 135 East 57th Street, LLC, landlord of a commercial building located at 135 E. 57th Street, New York, New York, seeks a declaratory judgment against the defendant, Daffy's Inc. which operates a retail clothing store in the building, that the defendant failed to timely renew the parties' lease agreement for an additional five-year term. There were two other causes of action in the complaint, namely fraud and breach of the implied covenant of good faith and fair dealing. They were not presented or considered at the trial.

The defendant seeks a declaratory judgment that it should be permitted to exercise the option to renew for the reasons that (a) the failure to exercise the option prior to its expiration was an "honest mistake" and therefore an excusable default; (b) non-renewal of the lease would result in a substantial and unfair forfeiture of its investment in the premises and loss of good will; and (c) the late exercise of the option did not cause prejudice to plaintiff.

A three-day trial bench was held on July 12, July 13, and July 30, 2010. Six witnesses testified at the trial, including C. Bradley Mendelson, a real estate broker with Cushman & Wakefield who was retained by plaintiff to market Daffy's premises following the lapse of the renewal option;

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John Joseph Ross, an investment banker whom Daffy's retained to seek out strategic partners for the growth and expansion of Daffy's chain of retail stores; Joseph Acquino, a real estate broker with Prudential Douglas Elliman who worked with plaintiff previously as a leasing agent; Marcia Wilson, the President and CEO of Daffy's; Bonita Rausch, an employee of Daffy's East 57th Street Store; and Allan Gross, Daffy's Comptroller.

A number of factual questions were before the Court, including (1) whether the defendant's default is excusable or whether the defendant's failure to give timely notice amounted to gross or willful negligence; (2) whether the landlord would suffer severe hardship if the lease were renewed; (3) whether the tenant acted with "unclean hands" or fraudulently in sending a backdated option letter to plaintiff, and (4) whether the tenant will suffer a substantial forfeiture if the lease is not renewed.

Opening statements were waived by the parties. At the commencement of trial, the parties agreed that plaintiff had established its prima facie case, and by stipulation, plaintiff rested after the following exhibits and deposition excerpts were moved into evidence (Trial Transcript ("TT"), July 12, 2010, at 3:11-5:5):

1. Exhibit 1: Lease dated June 14, 1994
2. Exhibit 2: Lease Amendment dated September 22, 1994.
3. Exhibit 3: Commencement Date Agreement dated November 11, 1994.
4. Exhibit 4: Second Lease Amendment dated September 19, 1995.
5. Exhibit 5: Certified Letter dated September 16, 1997 notifying Tenant of Assignment of Lease.
6. Exhibit 6: Draft Letter dated January 30, 2010.
7. Exhibit 7: Email dated February 4, 2010, from Daffy's Chief Financial Officer, Richard Kramer, to John Poblocki, plaintiff's employee, with attached "Option Renewal Letter."
8. Exhibit 8: Fascimile Option Renewal Letter dated January 30, 2010, transmitted with February 4, 2010-dated cover sheet.
9. Exhibit 10: Plaintiff's rejection letter dated February 5, 2010.
10. Exhibit 11: Plaintiff's rejection letter dated February 9, 2010.

11. Exhibit 12: Daffy's option letter dated February 9, 2010.

12. Exhibit 13: Email from Allan Gross, Daffy's Comptroller, to Marcia Wilson, President and CEO of Daffy's, dated September 9, 2009 (Lease Summary).

During the trial, plaintiff withdrew its second and third causes of action for fraud and breach of implied covenant of good faith and fair dealing. However, plaintiff insisted that it retain, as a defense to Daffy's request for equitable relief, a claim that "unclean hands" by Daffy's defeats its right to renew its Lease [Stipulation dated June 28, 2010]. At the close of defendant's case, plaintiff moved for a directed verdict, arguing that Daffy's had not met its burden of proof, and the parties were directed to submit post-trial papers, including questions for the verdict, proposed findings of facts and rulings of laws pursuant to CPLR 4213 (a).

As the trier of fact, I have weighed the character, demeanor, and interest of each witness (*Lauria v Lauria*, 187 AD2d 888 [3d Dept 1992]; 65 NYJur, Witnesses, §71, 233-234). The testimony of all the witnesses and experts were weighed considering the above factors. The party witnesses are interested in the result to be reached. I considered whether there was bias among these witnesses and have weighed any interests that may have colored their respective testimony

Having observed the testimony of the witnesses and reviewed the post-trial submissions, the Court makes the following Findings of Fact and Rulings of Law:

Findings Of Fact

A. The Lease and Option to Renew

1. Daffy's Inc. ("Daffy's") is a New Jersey corporation and tenant pursuant to a written Agreement of Lease June 14, 1994 (the "Lease"), as amended by a Lease Amendment September 22, 1994 (the "First Lease Amendment" as particularized by a Commencement Date Agreement dated November 11, 1994 (the "Commencement Date Agreement"), and as further amended by a Second Amendment to the Lease dated September 19, 1995 (the "Second Lease Amendment"), between TRST New York, Inc., LAFP New York Inc., and The Alaska Permanent Fund Corp., predecessors-in-interest to plaintiff

135 East 57th Street, LLC, as landlord and defendant Daffy's, as tenant, for the ground floor entrance, concourse level 1, and concourse level 2 (the basement and subbasement levels) in the building. The building is located at 135 East 57th Street, at the corner of Lexington Avenue. The initial annual rent was \$1.3 million.

2. The Daffy's Lease had an initial 15-year term, with rent increases every five years, so that Daffy's now pays \$1.7 million [Plaintiff's exhibit 1, at 2]. Daffy's also pays a portion of the Building's real estate taxes based upon a ratio of its space to the space of the entire Building, even though its subbasement and sub-subbasement space obviously is worth less than the street level retail space or the space in the luxury office tower above [Plaintiff's exhibit 1, at 3]. The Store has a small entrance on 57th Street, just large enough for two escalators and an elevator to reach sub-basement and sub-subbasement space, each about 25,000 square feet [Plaintiff's exhibit 1, Schedule A; TT 118:23-119:5].

3. Pursuant to the Commencement Date Agreement, defendant agreed that "the Term of the Lease will expire on January 31, 2011, and that this date constitutes the "Fixed Expiration Date" of the Lease.

4. At the time it obtained the Lease, Daffy's negotiated for two additional five-year renewal terms: the first at \$2 million a year; and the second at the greater of \$2.3 million or 90% of fair market value [Plaintiff's exhibit 1, at 81-83]. The first renewal was to have been exercised by January 31, 2010 [Plaintiff's exhibits 1 and 3].

5. Under Article 35 of the Lease, defendant's option to extend the Term of the Lease for a five-year period at an increased rental was exercisable by "written notice to Landlord given not later than twelve months prior to the Fixed Expiration Date (by January 31, 2010). The Lease required notice to be delivered in person or sent by certified mail to

6. When Daffy's leased the below grade retail space 15 years ago, it took a large business risk because no retailer had successfully operated in this solely below ground level space. Initially, it was built by the developer of the property to house a number of small antique stores, who were unable to operate successfully in the space. It remained vacant for a number of years before Daffy's leased the Store [TT 119: 6-8]. When Daffy's leased the Store, it had to

remove the many walls which had divided the space into separate antique stores and, then, to fit it out and equip it for use by a single retailer [TT 119:12-120:26; Defendant's exhibit KKK].

7. In 1997, plaintiff 135 East 57th Street, LLC ("Landlord"), controlled by Charles Steven Cohen, purchased the Building [Plaintiff's exhibits 1 and 5; John Poblocki dep., 15:2-6]. By a duly served letter dated September 16, 1997, plaintiff notified defendant that the leasehold had been sold and assigned to plaintiff.

8. The subject premises is a 54,000 square foot store. [TT 118:23-119:5]. Marcia Wilson ("Wilson"), President/CEO of Daffy's, Inc., testified that the Store is well maintained and painted on a regular basis. [TT 120:20-26]. However, Daffy's below ground Store has been plagued with water leaks flooding its space. The persistent leaks, which Landlord failed to resolve, made it difficult for Daffy's to make investments in the Store, including installing new flooring [TT 121:18-123:18; John Poblocki dep., 26:3-16].

9. While Landlord's exclusive retail broker testified that Daffy's was a "quality tenant" [TT 18:23-19:2], Mr. Cohen did not like Daffy's, claiming it to be a "low-class" establishment, with "a table with a million goods on them and people kicking at you" [Charles Cohen dep., 43:14-44:6]. Due to the general resurgence of the real estate market, the space now is worth more than the rent provided in the Lease [TT 37:18-38:19].

10. Prudential Douglas Elliman ("Prudential") was the prior exclusive retail leasing agent for plaintiff's managing agent, Cohen Brothers Realty Corp. ("Cohen Brothers") [TT 98:21-99:20]. During the course of Prudential's engagement, Joseph Acquino recommended to Charles Cohen ("Cohen"), principal of Cohen Brothers, that plaintiff attempt to buy out Daffy's Lease. [TT 104:26-125:3; see also exhibit A, Email from Acquino to Cohen, dated September 20, 2008, and exhibit B, Email from Acquino to Cohen, dated October 16, 2008].

11. Based on that recommendation, Mr. Cohen encouraged his retail broker to negotiate a buy-out so that he could obtain a new tenant for the Store [TT 110:6-17; Defendant's exhibit A; Charles Cohen dep., 61:3-4]. Prudential's retention as leasing agent, however, expired and was not renewed by plaintiff [TT 116:26-117:7].

12. Daffy's was able to operate the Store profitably [Defendant's exhibits XX, 29, 30 and 38; YY, 30, 31 and 39; and HHH, 30, 31 and 39].

13. Because Daffy's had developed a successful business at the Store, which was a key to the profitable operation of its whole business, it had no interest in moving [Defendant's exhibits B and LLL, 39]. When approached by Landlord's broker who suggested paying \$3 to \$4 million to buy out the Lease, Daffy's answer was "definitely not" because the Lease was too valuable and the location too important to Daffy's entire business. [Defendant's exhibits XX, 29, 30, and 38; YY, 30, 31 and 39; and HH, 30, 31 and 39].

B. Time and the Form of Exercising Option to Renew

14. Article 27 of the Lease specifies that "any . . . notices . . . required to be given under this Lease shall be in writing and shall be deemed sufficiently given or rendered if delivered by hand (against a signed receipt) or if deposited in a securely fastened, postage prepaid envelope in a depository that is regularly maintained by the US Postal Service, sent by registered or certified mail (return receipt requested) or if delivered to a nationally recognized overnight courier."

15. Daffy's did not exercise its option to renew the Lease on or before January 31, 2010.

16. At 10:29 p.m. on the last day for Daffy's to exercise its renewal, Steven Cherniak, Landlord's Chief Operative Officer, emailed Charles Cohen: "Good news. No notice from them. They clearly missed the deadline. We should wait a week or so before discussing a renewal at market . . ." [Defendant's exhibit C]. Mr. Cherniak then checked with the Building's property manager and the Accounting Department to confirm that Daffy's had missed the date for renewal of the Lease [Defendant's exhibit D].

17. On February 2, 2010, it was reported that Daffy's had tendered its rent, but that there was no correspondence with the check [Defendant's exhibit D].

18. Daffy's controller, Allen Gross, is responsible for tracking the renewal dates under Daffy's various real estate properties. He tracks the various renewal dates with a spreadsheet schedule that he called the "lease summary." [TT 201:20-24]. On February 4, 2010, only 4 days after the last day for Daffy's to renew the Lease, Mr. Gross realized

that he had missed the renewal date [TT 207:18-208:8;211:20-212:6].

19. Mr. Gross suffers from serious medical conditions, including adult onset Type II diabetes, scleroderma, glomera neuritis, psoriatic arthritis, and is an amputee [TT 209:2-211:13]. His physician labels his diabetes "brittle," meaning that he is subject to swings in his blood sugar levels. In his 25-year history of working at Daffy's, during which time his duties included assuring such renewals, he had never before missed a renewal date [TT 203:22-204:6; 208:6-9].

20. Lease Summaries were maintained in Gross' computer but, for important matters such as lease renewal dates, he relied upon his paper calendar which he kept on his desk and in which, among other things, he daily entered his blood glucose readings and Daffy's daily cash positions [TT 204:2-205:19; 208:9-26; Defendant's exhibits TT1 and TT2].

21. While he had ordered and obtained a new desk calendar for 2010, he failed to transfer the lease renewal dates from the Lease Summaries to it [TT 207:18-208: 5; Defendant's exhibit TT2].

22. On February 4, 2010, Mr. Gross had a severe hypoglycemic reaction in the morning. After lunch that day, he had occasion to look at the Lease Summary Schedule and it was then he realized that the 57th Street Option Renewal had passed.

23. Upon realizing that the deadline has lapsed, Mr. Gross went to see Richard Kramer, his supervisor and Vice President and CFO for Daffy's. Mr. Kramer told Mr. Gross to prepare a renewal letter (the "Renewal Letter") [TT 212:25-26; Plaintiff's exhibit 6].

24. Mr. Gross prepared the Renewal Letter and dated it January 30, 2010 (a Saturday). When asked why he had entered the January 30th date on the letter, he testified that "I was not quite back to myself after the reaction I had in the morning. I was fixated on that date because that was the date on the lease summary and I just typed it in." [TT 213:16-20]. The letter stated "This is to advise you that pursuant to Article 35.1 of the Lease, Daffy's is exercising its option to renew the Lease for an additional five years . . . beginning 2/11/11 to 1/31/16."

25. Mr. Kramer then read and signed the Renewal Letter and sent it to the Landlord by email showing it was sent

"Thursday, February 04, 2010 3:54:05 PM" [Plaintiff's exhibit 7; TT 214 : 8- 10; 214:18-20].

26. Subsequently, Mr. Kramer sent a second copy of the Renewal Letter by facsimile, with the time stamp "2-4-10; 6:05PM" [Plaintiff's exhibit 8; John Poblocki dep., 85:19-25].

27. Then Mr. Kramer placed two calls to John Poblocki, Landlord's Senior Vice-President, Director of Property Management, to confirm the notice, but Mr. Cherniak had instructed Landlord's employees, including Mr. Poblocki, not to speak to anyone from Daffy's [Defendant's exhibit BBB; TT 214:11-17; 236:6- 25; 261:8-18; John Poblocki dep., 14:16-15:6; 77:10- 16; 77:25-78:14; 84:5-9; 85:19-86:18]

28. Mr. Gross also mailed the original signed Renewal Letter, with a February 5, 2010 postage meter stamp, to Landlord [TT 215:8-14; Defendant's exhibit MMM].

29. By letter dated February 5, 2010, plaintiff's counsel, Jay Itkowitz, rejected the Option Renewal Letter, stating that defendant had fraudulently backdated the Option Renewal Letter, that defendant's Option had lapsed on January 31, 2010, and that the manner in which defendant had served its Option Letter, by email and fascimile transmission, were invalid under the Lease. [Plaintiff's exhibit 10]. Daffy's delivered a second Renewal Letter on February 9, 2010 precisely in the manner required by the Lease [Plaintiff's exhibits 1 and 12].

30. Landlord commenced this action on February 11, 2010, alleging bad faith and fraud by Daffy's [Complaint].

C. The Real Estate Market for Commercial Properties

31. Charles Bradley Mendelson ("Mendelson") of Cushman & Wakefield is the exclusive retail leasing agent for plaintiff for the subject building following the lapse of defendant's option for the premises, as well as the building owners' other retail properties [TT 6:18-22, 8:9-19]. Mendelson is also the exclusive leasing agent for a commercial property located at 666 Fifth Avenue. He testified that in or around 2009, Daffy's brokers attempted to make an offer for certain retail space located at 666 Fifth Avenue. This building is located in an office district known as the "Plaza District." Daffy's Store at 135 East 57th Street, though not in a clearly defined district, straddles the "Plaza District," "Midtown East" and what is

known as the "Bloomingdale's shopping area." [TT at 8:21-25, 9:16-18, 9:24-10:2, 10:9-11:13].

32. Mendelson further testified that multiple retail stores are frequently located within a single district, even though such stores compete with each other because the "overall volume done between the two stores would be substantially greater than the volume done on one. While opening the second store, not too far away, they may cost themselves some sales in the store that is already open, but they more than duplicate it and triplicate it by opening a second location." [TT 14:11-15:6-12].

33. Daffy's sent a letter of intent to the landlord of 666 Fifth Avenue on February 10, 2010. The premises at 666 Fifth Avenue, consisting of 90,000 square feet on the ground floor, second floor and third floor were leased in May 2010 to a company called Uniqlo, which like Daffy's, is a retailer that offers fashion clothing at lower prices. [TT 19:3-10]. However, that space was not intended to be an alternate location for the East 57th Street Store. Aside from being in a different retail district, the space was eventually leased for \$190 per square feet (500% more than Daffy's current rent at the East 57th Street Store). [TT 32:12-26; Plaintiff's exhibit 1, at 2].

34. Fidus Partners ("Fidus") and Daffy's have had a long-term relationship. From 2006 through 2007, Fidus worked on a potential sale of the business. For the past twelve to eighteen month, Fidus is providing advisory services to secure liquidity for shareholders and to find strategic partners to provide capital for growth. [TT 41:4-11].

35. John Joseph Ross II, an investment banker with Fidus, was involved with Daffy's management in the preparation of a Confidential Information Memorandum ("CIM") which was an offering memorandum for potential investors. [TT 41:16-20]. Following voir dire, four drafts of the CIM dated December 11, 2009, January 26, 2010, February 12, 2010, and March 2010 (Defendant's exhibits XX, YY, HHH and LLL respectively) were introduced into evidence as Fidus' business records. In the ordinary course of business, the drafts are finalized, then sent to management for final approval and if management approved the CIM, it would be sent out to investors. [TT 52:4-12].

36. Ross testified that the EBITDA (earnings before interest, taxes, depreciation and amortization) was a key financial measure in the CIM. [Id.]. He further testified that the East 57th Street Store's EBIDTA was \$3.3 million, and that the company's annual EBITDA was \$8.0 million. This

testimony was contradicted by Ms. Wilson who testified, and the Court credits, that the EBIDTA for all stores was \$28 million in 2009. [TT 191:14-22]. The Herald Square Store is Daffy's largest in terms of square footage and profitability. [TT 132:12-14, 133:13-16].

37. The information in the CIM regarding the current real estate industry and market was provided by Daffy's and its real estate consultant, Art Burak. [TT 65:12-20, 66: 11-67:8]. The March 2010 CIM indicates that Daffy's currently has a chain of eighteen retail stores, including seven stores in Manhattan, seventeen stores in the Greater New York Metropolitan Area, and one store in Philadelphia [Defendant's exhibit LLL, at 1, 30].

38. Ross further testified that the following quoted statements from the CIM were accurate:

(a) "Daffy's has opened six new stores in strategic locations in the past ten years. And management believes that lease rates for retail spaces have declined from the record high levels of recent years...significantly increasing the number of attractive new store opportunities available to Daffy's..." [TT 68:10-69:4 citing March 2010 CIM, exhibit LLL, at 3].

(b) "Daffy's management is planning a strategy to more fully capitaliz[] [sic] on Daffy's growth opportunities, focusing on boosting existing store's performance and accelerating the pace of new store openings...[TT 69:5-12].

(c) "Daffy's highly reputable new store model is a proven success in a variety of urban and suburban markets both within and outside the New York Metropolitan area. Management plans for the company with its current corporate infrastructure to open eight new stores between 2010 and 2014. This plan is primarily focused on opening stores in the greater New York Metropolitan area..." [TT 69:16-25].

(d) "Increasingly favorable commercial real estate dynamics are expected to increase the number of viable locations in which Daffy's could open new stores. Management believes there are numerous opportunities to open new stores in New York and in the New York Metropolitan area." [TT 70:25-71:11].

(e) "While new store growth has moderated... due to an overheated New York Metropolitan real estate market, management believes that improving real estate market conditions should increase the number of attractive store opportunities available to the company In addition, the company's unique capacity to accommodate nontraditional

spaces [] significantly increases the number of attractive prospective [sic] locations for new Daffy's stores...." [TT 79:12-80:3.

39. In light of these statements from the March 2010 CIM, Ross testified that a meaningful part of Daffy's ability to open new stores is based upon its existing business model.

40. However, according to Ross, those statements regarding Daffy's "Growth Plan," "New Store Growth" and "Growth Opportunities" are hopeful projections to entice potential investors. [TT 184:21-25].

41. While Daffy's has a flexible approach to retail space and would consider office space, it is more difficult to open a store in office space. The current space is a "perfect retail box." [TT 38:7-14; 177:22-178:3, 178:21-179:3, 195:19-24.

42. Through Arthur Barak, Daffy's real estate consultant, the store has searched for available retail space in the area of the Store and concluded that there is no available appropriate space. [TT 130:12-16, 144:5-16, 179:9-26, 195:14-18].

43. Ms. Wilson testified that Daffy's had successfully signed a lease for a store in the Bronx that is due to open this year. However, despite looking for alternative spaces since 2009, no such space was found in Manhattan, including for the East 57th Street Store area.

44. Ms. Wilson further testified that when Daffy's Store at 18th Street and Fifth Avenue closed in January 2006, Daffy's needed approximately 13 months to renegotiate a lease in that building, and that after taking back approximately one-third of the space previously leased, the effect on customer traffic and sales from that location was "devastating."

D. Possible Impact on Plaintiff and Defendant

45. Daffy's would lose a store with an EBIDTA of \$3.3 million, the second highest EBIDTA of Daffy's stores (second only to the Herald Square Store that makes approximately \$100,000 more). It would take approximately one year to find an available appropriate space. [TT 144:5-16, 179:9-26, 130:12-16, 195:14-16.

46. Ms. Wilson testified that if Daffy's lost the East 57th Street Store, most of the 114 employees at that store would be left unemployed. [TT 135:9-13]. If the employees

were unemployed, they would lose their health insurance, retirement and other valuable benefits.

47. Wilson further testified that if Daffy's lost the \$3.3 million per year in store-wide EBITDA, it would be in default of unspecified bank covenants and loans. [TT 135:9-13, 136:23-137:8]. She also expected that the new Daffy's store in the Bronx would increase the company EBITDA, but claimed it would be insufficient to sustain her financing if Daffy's lost the East 57th Street Store. [TT 199:16-20].

48. She also testified that if she lost the store, it would be difficult to sell Daffy's at favorable terms, and she would not be able to refinance in order to "have the opportunity to grow the company." [TT 197:2-14]. The East 57th Street Store is one of Daffy's flagship and showcase store. [TT 133:4-12]. Therefore, the loss of the Lease would have a significant adverse effect on Daffy's value. [TT 75:13-16; 136:4-22; 197:2-15].

49. Daffy's credit lines are fully extended. Ms. Wilson testified that she had to pledge her personal real estate, which is leased to Daffy's to guarantee the debt. If Daffy's income dropped significantly, the banks would not finance any new debt. [TT197:8-12].

50. Mr. Mendelson testified that he represents the ownership for a building located at 400 Park Avenue, where Syms was leasing approximately 60,000 square feet of space. That space was on the market for approximately one year. Syms renewed its lease sometime in May 2010.

51. When asked if he could find a 50,000 square foot space for \$2 million a year, the stipulated base rent at present at the East 57th Street location, Mendelson stated that he believed a comparable space could be found with rent somewhere from \$2 million and \$2.75 million per year. [TT 37:4-17].

52. Mendelson also testified that plaintiff's current asking price for the subject premises is \$85.00 per square foot or \$4.25 million per year (\$85.00 x 50,000 square feet). This price is based on the fact that the subject premises was a highly improved, "perfect retail box" when Daffy's took it. [TT 37:18-38:14].

53. Bonita Rausch, an employee at the East 57th Street Daffy's Store, testified about the good will and customer loyalty at the store. [TT 169:10-11]. She has been at the Store approximately fifteen years. She thought that 50% of the store's customers were repeat customers. The customers

come from all over New York City. [TT 174:9-12]. The Court does not credit this as more than conjecture.

55. The Store has 800,000 customer visits annually with a conversion rate of 44%, meaning that 44% of customers who walk into the Store make a purchase. This is the highest conversion rate of all of Daffy's New York City stores. [TT 123:19-124:22].

56. Any rental space which might be available would be at a substantially higher rental rate. [TT 32:12-26].

57. Since 2009, Daffy's has been looking for new store locations in New York City. It has only been successful in signing a lease for 27,000 square feet in the Bronx; it has located no available space in the vicinity of the current Store. [TT 129:26-130:16, 131:16-22, 137:19-138:4].

Rulings of Law

A. Guiding Principles of Law

The law in New York is well-settled. The general rule is that an option must be exercised strictly according to the terms and conditions in the option. Accordingly, a notice exercising an option is ineffective if it is not given within the time specified. *J.N.A. Realty Corp. Vv Cross Bay Chelsea, Inc.*, 45 NY2d 392, 396-397 (1977) citing to Restatement, Contracts 2d (Tentative Draft No. 1, 1964) s 64, subd (b); 1A Corbin, Contracts (1963), s 264; 1 Williston, Contracts (3d ed 1957), s 87; *Sy Jack Realty Co. v Pergament Syosset Corp.*, 27 NY2d 449; see also *American Realty Co. v 64 B Venture*, 176 AD2d 226, 227 (1st Dept 1991) ("an election to renew must be timely, definitive, unequivocal and strictly in compliance with the lease term"); *5 East 41 Check Cashing Corp. v Park & Fifth Owner, LLC*, 44 AD3d 373, 373 (1st Dept 2007).

Notwithstanding the general rule, a trial court may invoke its equitable power and order specific performance of Daffy's option to renew its Lease. The New York courts have pronounced a formula to find when the late exercise of an option provision will be excused. It is essentially, a three-part test: (a) that the tenant's failure or delay was the result of inadvertence or an honest mistake, (b) that the delay has not prejudiced the landlord by a change of position, and (c) that the failure to give relief to the tenant would result in a substantial loss or forfeiture to the tenant, making the strict enforcement of the option

renewal provision unconscionable. *J.N.A. Realty Corp. v Cross Bay Chelsea, Inc.*, 45 NY2d 392, 396-397 (1977); *Cooper, O.D. v Number 535 Park Avenue*, 73 AD3d 433 (1st Dept 2010); *Street Beat Sportswear, Inc. v Waterfront Realty, Co.*, 6 AD3d 693 (1st Dept 2004); *Soho Development Corp. V Dean & DeLuca Incorporated*, 131 AD2d 385, 387 (1st Dept 1987). The determination of the court turns not on a single factor, but on the "balancing of the equities" between the parties.

Turning to the present case, it is undisputed that the defendant failed to timely exercise its option to extend the lease agreement. Thus, the lease agreement between the parties terminated at midnight on January 31, 2010.

B. Balancing the Equities

In order to demonstrate that it is entitled to equitable relief, Daffy's bears the burden of proving by a preponderance of the evidence that (1) its conduct was not intentional, willful or grossly negligent; (2) the Landlord did not rely to its detriment on Daffy's failure to give timely notice; (3) strict enforcement of the option/notice provisions would result in a significant forfeiture to Daffy's; and (4) within the context of giving notice, Daffy does not have "unclean hands." The Court adopts this standard and finds that Daffy's has met its burden.

The Court first finds that Daffy's had the long-determined intention to exercise the option clause in the Lease agreement. At trial, Mr. Gross testified that Daffy's had every intention of extending the lease and Landlord had notice of this as evidenced by the improvements that Daffy's made to the premises, including painting. There was no evidence to the contrary.

A lease summary was prepared by Mr. Gross listing the expiration date of the lease as January 30, 2010. Mr. Gross also relied on a paper calendar to remind him of the lease expiration date. Mr. Gross' failure to properly calendar the renewal date for 135 East 57th Street Store was an inadvertent mistake or oversight. This is not an instance of an intentioned or willful failure to timely renew. At the earliest opportunity, four days after January 30, 2010, Daffy's performed its part of the contract and gave notice. The Landlord does not dispute that notice was given. A four-day delay within the context of a potentially 25-year lease duration is not unreasonably long.

The case involves a commercial property where a profitable business is conducted and has been conducted for approximately fifteen years. It is unclear the amount of monies spent to renovate the space. However, the trial record shows that Daffy's made certain alterations to the space at its own expense, including tearing down walls and customizing the space for its needs i.e. telephone equipment. As well, Daffy's remains liable for repayment of all loans or mortgages on the space. The law abhors the forfeiture of a leasehold interest (*Mooney v Byrne*, 163 NY 86 [1900]). To declare the lease forfeited, and the option to renew lost, would cause great harm to Daffy's.

The "good will" of a business enterprise is a substantial and valuable asset, and deserving of protection against forfeiture so as to invoke equitable relief to a tenant who fails to timely exercise its right to renew a lease (see *Sy Jack Realty Co. v Pergament Syosset Corp.*, 27 NY2d 449, 453 n1 [1971]; *Grunberg v George Assocs.*, 104 AD2d 745 (1st Dept 1984) (tenant, a retail gift boutique, claimed (hat it made substantial improvements to the leasehold and established valuable good will at the present location)).

Daffy's had no reason to give up one of its most profitable stores. Additionally, the East 57th Street Daffy's Store is undeniably a long-standing retail location. There is certainly customer recognition of its location as evident in the store's profits. Daffy's also took a risk in renting subbasement and sub-subbasement space which no single retailer had ever attempted to use and refitted it, and effectively merchandised the space. Daffy's would forfeit these benefits it achieved. As well, approximately 114 employees would lose their jobs and benefits if the store were to close without having an alternative space.

On the other hand, allowing the defendant to extend the lease would not substantially harm plaintiff. See *Dan's Supreme Supermarkets, Inc. v Redmont Realty Co.*, 216 AD2d 512 (2d Dept 1995) (the landlord's inability to consummate a valuable lease because of the unavailability of the premises would clearly be prejudicial); *Nanuet National Bank v Saramo Holding Co.*, 153 AD2d 927 (2d Dept 1989), *lv denied* 75 NY2d 705 (1990) (after trial court held that tenant's equitable interest was established because of the good will that it developed at premises constructed to suit tenant's particular needs and tenant had approximately 1500 customers).

The test for determining whether plaintiff was harmed by the delay of four days is whether it changed its position

or suffered a detriment because of Daffy's delay in giving notice of the lease renewal. *Chock Full O'Nuts Corp. V NRP LLC I*, 11 AD3d 385, 386 (1st Dept 2004). Plaintiff contends that its ability to market the leasehold space has been greatly hindered. Plaintiff, however, has failed to show that it either negotiated or made any commitments to the rental of the space at 135 E. 57th Street based on the expectation that Daffy's lease would expire on January 30, 2010. Absent some specific commitment to rent the premises, plaintiff's allegations of prejudice are speculative. See *Beltrone v Danker*, 228 AD2d 763,764 (3d Dept 1996) (court found "of greater significance is the fact that defendants have made no showing that they have a prospective tenant or that they were otherwise prejudiced as a result of plaintiff's two-month delay in giving notice"); 537 *Greenwich LLC v Chista Inc.*, 19 Misc 3d 1133 (A) citing to *Dan's Supreme Supermarkets, Inc. v Redmont Realty Co.*, *supra*; *Nanuet National Bank v Saramo Holding Co.*, *supra*, at 929 (landlord failed to establish prejudice from belated lease renewal "other than possible loss of financial windfall").

Without more, this possibility cannot be attributable to any delay in defendant's exercise of its option to renew (*Sy Jack Realty Co. v Pergament Syosset Corp.*, 27 NY2d, *supra*, at 453 [stating that landlord did not suffer any damage or prejudice because of the delay resulting from the non-delivery of the defendant's letter exercising renewal option]; see generally *J.N.A. v Cross Bay Chelsea, Inc.*, 42 NY2d at 400 [requiring trial on issue of prejudice to explore whether after the tenant's default the landlord, made other commitments for the premises]).

Plaintiff raises the equitable defense of "unclean hands." A party cannot successfully invoke the court's equity powers if it comes to court with unclean hands, having engaged, as alleged here, in fraudulent conduct. See generally *Levy v Braverman*, 24 AD2d 430 (1st Dept 1965). Specifically, plaintiff contends that Daffy's falsely represented that it had signed the option renewal letter on January 30, 2010. Plaintiff relies on *USA Network v Jones Intercable, Inc.* (729 F Supp 304 [SD NY 1990]), where the Court ruled that, as a matter of law, plaintiff's failure to timely renew its option precludes equitable relief. In *USA Network*, the defendant also backdated its letter, and changed the date on the postage meter. Additionally, affidavits were submitted denying the backdating.

In this case, Daffy's has acknowledged that its renewal letter was four days late. Mr. Gross did backdate the initial renewal letter sent to the Landlord, but did not subsequently misrepresent the date on other materials. While Mr. Gross did date the renewal letter "January 30, 2010," it was sent by email, fax and regular mail with the correct date stamped on the email, fax cover sheet and envelope. The Court is not convinced that Gross' wrongful dating in this case rises, under all the circumstances, to a serious enough level to justify preclusion of access to equitable relief.

As well, the Landlord has not proven any damage from its claim that it was defrauded by Daffy's or from Daffy's alleged "bad faith". It did not rely on any alleged "misstatement" of Daffy's. To the contrary, Landlord's officers and employees admitted that they knew that the Renewal Letter was emailed, faxed and mailed on February 4, 2010.

After balancing the equities of this case, the Court finds that Daffy's failure to timely exercise the Lease renewal option was an honest mistake, that the delay was slight, that Daffy's would suffer a significant forfeiture if the Lease is not renewed, and that defendant has demonstrated an absence of prejudice to plaintiff from the four-day delay in exercising the renewal option.

Specifically, the Court finds:

- (1) the defendant's default is the result of an honest mistake, is excusable and is not the result of gross or willful negligence; and
- (2) plaintiff would not suffer severe hardship if the lease were renewed; and
- (3) tenant's agent wrongfully backdated the option letter but the landlord did not rely upon the misrepresentation and landlord was not prejudiced or injured by it; and
- (4) tenant will suffer a substantial and unfair forfeiture of its investment in the premises and loss of good will if the lease is not renewed.

Accordingly, the late notice of renewal is excused and it is

ORDERED, ADJUDGED and DECREED that a declaratory judgment should be entered in favor of the defendant and against the plaintiff; and it is further

ORDERED that the Clerk of the Court is directed to enter judgment accordingly.

Dated: October 13, 2010

OCT 13 2010

ENTER:

James A. Yates, J.S.C.

James A. Yates

FILED
Oct 13 2010
NEW YORK
COUNTY CLERK'S OFFICE