Michigan Law Review

Volume 56 | Issue 1

1957

Future Interests - Rule Against Perpetuities - Legislation Exempting Options to Purchase in Leases

Edward A. Manuel S.Ed.
University of Michigan Law School

RECENT LEGISLATION

FUTURE INTERESTS—RULE AGAINST PERPETUITIES—LEGISLATION EXEMPTING OPTIONS TO PURCHASE IN LEASES—A recent West Virginia statute provides that in all leases subsequently executed, an option to purchase the whole or any part of the leased premises exercisable during or at the end of the term is not subject to the rule against perpetuities. The statute also provides that the rule against perpetuities shall not constitute a defense to a suit to enforce such an option against the lessor. W. Va. Code (Michie, Cum. Supp. 1957) §3541(3).

This legislation was evidently passed in response to the recent case, *First Huntington National Bank v. Gideon-Broh Realty Co.*,[1] which apparently is the first case in the United States to hold that the rule against perpetuities invalidates an option to purchase contained in a lease if it can be exercised beyond the period of the rule.[2] In that case the court reasoned that since the option was specifically enforceable, it was an interest in the land; and that since the fee would not vest until the option was exercised, which might be after the period of the rule, the option was void.[3] This result as to options contained in leases has also been reached in England,[4] and courts in both the United States and England have used this reasoning to invalidate options in gross, that is, options held by a stranger to the title.[5] English courts have argued, however, that either type of option is not only a limitation on the estate which may be invalid under the rule, but also a personal covenant to which the rule has no application.[6] They have therefore allowed an action for specific performance against the original covenantor if he still holds property,[7] and an action for damages if he has transferred it.[8] As to options in gross, courts in the United States have refused to grant specific performance, even against the original covenantor,[9] and have also refused to award damages.[10] On the other hand, with the exception of the *Huntington Bank* case, the limited authority in the United States appears to be unanimous in holding completely enforceable the option to purchase contained in a lease even

1 139 W. Va. 130, 79 S.E. (2d) 675 (1953).

2 SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §1244 (1956); 53 MICH. L. REV. 147 (1954); 11 WASH. & LEE L. REV. 263 (1954); 56 W. VA. L. REV. 128 (1954).

3 First Huntington Nat. Bank v. Gideon-Broh Realty Co., note 1 supra, at 142

4 Worthing Corp. v. Heather, [1906] 2 Ch. 532.

5 London and South Western Ry. Co. v. Gomm, [1882] 20 Ch. 562. See cases collected in 162 A.L.R. 581 (1946).

6 See Hutton v. Watling, [1948] Ch. 26, noted in 12 CONVEYANCER AND PROPERTY LAWYER (n. s.) 237 (1948).

7 South Eastern Ry. v. Associated Portland Cement Manufacturers, Ltd., [1910] 1 Ch. 12, followed in Hutton v. Watling, note 6 supra.

8 See Worthing Corp. v. Heather, note 4 supra.

9 E.g., Emerson v. Campbell, 32 Del. Ch. 178, 84 A. (2d) 148 (1951).

10 Fastman Marble Co. v. Vermont Marble Co., 236 Mass. 138, 128 N.E. 177 (1920).

though it might be exercised beyond the period of the rule.[11] In reaching this result, the courts have pointed out the analogy to the perpetually renewable leasehold, which both English and American authorities have always regarded as valid,[12] and have alluded to the commercial desirability of such an arrangement.[13] There is much to be said in support of the American distinction between options in gross and options contained in leases. As a basic proposition it can be argued that the application of the rule against perpetuities to options of any kind is unwise. The rule came into being as a safeguard against unduly long family settlements, and it is difficult to see how the period of lives in being is relevant to commercial transactions, where the option contract is normally used.[14] The void *ab initio* result of the rule often works undue hardship in a business setting where one party finds that he can escape an unfavorable bargain.[15] Particularly in the case of the application of the rule against perpetuities to options contained in leases is the result completely inconsistent with the policy reasons behind the rule. Instead of insuring the full utilization of land, striking down the option to purchase means that the lessee, the only person who can develop the land during the lease, must limit his improvements to those which can be fully depreciated by the end of the term.[16] Application of the rule to options in gross is probably justifiable because, after the option is given, the owner is prevented from fully utilizing the land since the optionee can always exercise the option and claim the benefit of the owner's investment. Many writers have, therefore, argued that

[11] See note 2 supra; Hollander v. Central Metal and Supply Co., 109 Md. 131, 71 A. 442 (1908); Keogh v. Peck, 316 Ill. 318, 147 N. E. 266 (1925). This American position was reaffirmed in L. L. Dozier v. Troy Drive-In-Theatres, Inc., 265 Ala. 93, 89 S. (2d) 537 (1956). The court in the Alabama case cites PROPERTY RESTATEMENT §395, at p. 2326 (1944), which adopts the American view. Options to purchase in leases were upheld without discussion of the rule against perpetuities in Prout v. Roby, 15 Wall. (82 U.S.) 471 (1872), and Hagar Administrator v. Buck, 44 Vt. 285 (1872). See also McKown v. Heery, 200 Ga. 819, 38 S. E. (2d) 425 (1946), and Todd v. Citizen's Gas Co. of Indianapolis, (7th Cir. 1931) 46 F. (2d) 855, cert. den. 283 U.S. 852 (1931).

[12] SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §1243 (1956).

[13] See, e.g., Hollander v. Central Metal and Supply Co., note 11 supra.

[14] SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §1244 (1956); Berg, "Long-Term Options and the Rule Against Perpetuities," 37 CALIF. L. REV. 1 at 21 (1949); 6 AMERICAN LAW OF PROPERTY §24.56 (1952). On the other hand, if the policy of the rule is stated in terms of striking a balance between the desires of a present generation and those of a future generation, it seems at least arguable that the period of the rule is equally applicable to such options. That such a balance is one of the policies behind the rule, see SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §1230, p. 135 (1956).

[15] Leach, "Perpetuities in Perspective: Ending the Rule's Reign of Terror," 65 HARV. L. REV. 721 at 737 (1952). In New York options whether in gross or contained in a lease and unlimited as to time are valid and specifically enforceable. See Matter of City of New York, (Upper New York Bay) 246 N.Y. 1 at 29, 157 N.E. 911 (1927). See also this same result in other "two lives" jurisdictions, e.g., Mineral Land Investment Co. v. Bishop Iron Co., 134 Minn. 412, 159 N.W. 966 (1916). As pointed out in Leach and Morris, "Options to Purchase and the Rule Against Perpetuities," 18 CONVEYANCER AND PROPERTY LAWYER (n.s.) 576 (1954), little objection has been raised to such options in these states.

[16] SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §1244 (1956).

even the period of the rule is entirely too long for this type of interest.[17] Also, unlike the case of the option in a lease, the optionee has no rent obligations and may be in a position to refuse to release his interest in the hope of a speculative profit. This creates a substantial practical restraint on alienation.[18] The option in a lease, on the other hand, adds to the attractiveness of the possessory interest, thus increasing alienability, at least to the lessee. Moreover, if land values have dropped drastically the lessee is likely to be willing to release his interest in what has turned out to be a losing contract.

The statute recently enacted in West Virginia, while salutary in most respects since it reaffirms the position of American authorities in favor of purchase options in leases, is subject to one possible objection. Unless limited by the second provision of the statute, which is concerned only with options held by lessees, the first provision could be construed to validate all options in leases.[19] Thus, just as the lessee may be able to obtain an option to purchase the reversion, the lessor may be able to retain an option to purchase the leasehold interest. Such an option to purchase in the hands of the lessor would not turn the tenancy into a tenancy at will, for the lessor must pay the option price before the tenancy can be terminated and he may be unwilling or unable to do this. Meanwhile, however, the owner of the possessory interest, the lessee, could not risk improvement which would fully utilize the land since his interest would be subject to the lessor's option.[20] Such a misinterpretation of the statute should be avoided since the option to purchase retained by the lessor contains the same dangerous possibilities as the option to purchase held in gross.

Edward A. Manuel, S. Ed.

[17] See Berg, "Long-Term Options and the Rule Against Perpetuities," 37 CALIF. L. REV. 419 at 448 (1949); Langeluttig, "Options To Purchase and the Rule Against Perpetuities," 17 VA. L. REV. 461 at 471 (1931). It is stated in Leach, "Perpetuities in a Nutshell," 51 HARV. L. REV. 638 at 661 (1938), that "to allow such a restraint to last for the period of perpetuities is monstrous."

[18] See Berg, "Long-Term Options and the Rule Against Perpetuities," 37 CALIF. L. REV. 419 (1949).

[19] The statute should be construed to validate only options held by lessees since the second provision of the statute in disallowing the defense of the rule against perpetuities when lessors are sued uses the term "such options" to refer to the options affected by the first portion of the statute. Reinforcing this construction is the fact that the statute appeared in the aftermath of the Huntington Bank case, note 1 supra, which dealt with an option in the lessee. Of course the lessor can accomplish substantially the same result as an option to purchase by inserting an express condition in the lease. An optional right of reentry for breach of condition is outside the rule. See SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §1245 (1956).

[20] Another objection to the rule adopted by the statute was suggested to the court in the Huntington Bank case, note 1 supra. See 11 WASH. & LEE L. REV. 263 at 268 (1954). If *A* leases to *B* for a 30-year term with an option in *B* to purchase the reversion, and *B* immediately subleases back to *A* for a term of 29 years, the result is in effect an option in gross in *B* for a period beyond the rule. There seems to be no way of guarding against the possible danger of speculative tying up of property by this device without invalidating options contained in leases in toto. Perhaps we can rely on the self interest of owners of land to prevent this type of transaction.