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Contracts—Effect of Percentage Lease in Self-Renewing Contract

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EFFECT OF PERCENTAGE LEASE IN SELF-RENEWING CONTRACT

In *Feder v. Caliguira*,[12] the Court of Appeals rendered its first interpretation of Section 399 of the General Business Law.[13] Two major questions are presented in this case: 1. Do the circumstances herein set forth conform to the Court's definition of a lease? 2. Is this business contract within the purview of the legislative intent of Section 399, regardless of whether it is or is not a lease?

The parties to this action entered into a contract, whereby the plaintiff agreed to furnish a "juke box," supply the records and keep it in repair, for which he would receive the first $20 of profits and 50% of all profits over $40. The plaintiff at all times reserved ownership of the machine. The defendant restaurateur, for his part, would supply the space and electricity. He further agreed to keep it in readiness for operation during all business hours and to arrange for assumption of the agreement by any purchaser of the business. In consideration for the above he was to receive the second $20 of profits and the same percentage as the plaintiff.

The contract was to run for a period of three years with an automatic renewal provision for like periods in the event that neither party gave notice to terminate thirty days prior to the expiration of the contract. After the expiration of the three years, but without having given the required thirty days notice, the restaurateur demanded that the plaintiff either remove the machine or pay a $500 bonus. The plaintiff removed his machine and brought this action for breach of contract.

In the lower courts both parties had received summary judgment. The Appellate Division held that this was not a case for summary judgment and remanded the case for trial. The application of Section 399 of the General Business Law to this contract was, with the permission of the Appellate Division, certified to the Court of Appeals.

The lessee of the juke box contends that this contract comes within the protection of Section 399, which places an affirmative duty on the lessor to give him notice of renewal at least fifteen days and not more than thirty days previous to the renewal. Since the lessor failed to give the required notice the contract was not renewed and therefore could not have been breached.

The Court of Appeals held that this contract was not a lease nor a business contract included within the protection of Section 399. Thus the

12. Feder v. Caliguira, 8 N.Y.2d 400, 208 N.Y.S.2d 970 (1960).
13. N.Y. General Business Law § 399:
No provision of a lease of any personal property which states that the term thereof shall be deemed renewed for a specified additional period unless the lessee gives notice to the lessor of his intention to release the property at the expiration of such term, shall be operative unless the lessor, at least fifteen days and not more than thirty days previous to the time specified for the furnishing of such notice to him, shall give to the lessee written notice, served personally or by mail, calling the attention of the lessee to the existence of such provision in the lease.

contract by its own terms renewed itself and was in effect at the time the breach was committed.

The Court defines a lease as the transfer of absolute control and possession of property at an agreed rental. In applying this definition to the present fact situation, the Court places great emphasis on the lack of a fixed rental obligation in this agreement. Since defendant is allowed to share in the proceeds of the machine, the Court reasons that he is being paid by the owner for allowing the machine to be placed in his restaurant. This negates the possibility that it is being leased by the plaintiff to the defendant. The Court summarily dismisses the possibility that the rent might be a percentage of the restaurateur's gross receipts from the operation of the juke box by saying that there is no rental obligation whatsoever imposed on the defendant. To the Court he is merely sharing in the receipts of the plaintiffs' own machine.

To further substantiate their premise that this agreement is not a lease, the Court points to the limited control the defendant may exercise over the machine. The control is limited to keeping the machine connected to an electric outlet and in readiness for operation during all business hours. The plaintiff reserved the sole property right in the machine and the defendant is not given use of the machine, the right to control its use nor any other form of dominion over it. To the Court this is inconsistent with their definition of a "lease."

Though this is not a lease, the Court goes on to examine whether it was the legislative intent to include this type of agreement within the protection of Section 399. To do this it is necessary to consider prior judicial constructions, for when there has been prior judicial construction of a word, the Legislature is deemed to have used it in the same context.[14] In the case of *Wash-O-Matic Laundry Co. v. 621 Leffert Ave. Corp.*,[15] an agreement for the installation and maintenance of coin operated laundry machines for the use of the landlord's tenants was held to be a license and not a lease of the space to the owner of the machines. On the basis of the *Wash-O-Matic* case, *Halpern v. Silver*,[16] *Kaypar v. Fosterport Realty Corp.*[17] and other similar cases, the Court feels that the term lease has been judicially defined as an agreement which transfers exclusive possession at an agreed rental. Since in the instant agreement neither criterion is fulfilled, this is not a lease, but rather a license given by the defendant to the plaintiff. In return for use of defendant's premises, a consideration in the form of a percentage of profits is given to defendant restaurateur. Therefore this agreement is not included within the purview of the word lease as used in the statute.

The evil sought to be corrected by this Section, was the infliction of continuing and, at times, heavy *financial* burdens, upon unwary businessmen

14. N.Y. Statutes § 75 (McKinney).
15. 191 Misc. 884, 82 N.Y.S.2d 572 (Sup. Ct. 1948).
16. 187 Misc. 1023, 65 N.Y.S.2d 336 (City Ct. 1946).
17. 1 Misc. 2d 469, 69 N.Y.S.2d 313 (Sup. Ct. 1947).

by automatic renewal clauses.[18] The clause itself is not against public policy since it is allowed to operate if notice of the renewal is given. In the instant case no financial burden was placed on the businessman and, therefore, this does not fall within the protection of the statute nor does it fall within the meaning of the term lease as used therein.

It appears to this writer that the whole key to the Court's decision can be found in the previous paragraph. The Court speaks of the element of control, but the real emphasis appears to be placed on the lack of any real financial burden on the defendant. If a real financial burden was placed on the defendant it appears that the Court might have relaxed its formal definition of a lease and decided the case differently. If this assumption be true, then the dissenting position is strengthened.

In the dissenting opinion it is pointed out that a rent may take many varying forms and should be measured by the value of the obligation assumed by the lessee. It is the view of the dissent that the furnishing of space and electricity, coupled with the obligation to have a subsequent lessee of the premises assume the lease, is in total a rent. It is pointed out that percentage rentals are extremely common today and are used for a variety of purposes.[19] Perhaps then the real disagreement between the minority and majority opinions revolves around what is a rent, rather than what is a lease.

All of the cases cited by the majority, with one exception, deal with a lease of real property. The only case which they cite which is directly in point to a lease of personal property is *Peerless Towel Supply Co. v. Triton Press*.[20] The case involved the installation and servicing of a towel machine in consideration for a fixed rental charge. The arrangements were substantially the same as in the present case and it was held to be a lease of the machine. The majority points to this case as an example of the type of evil at which the section is aimed, *i.e.*, a fixed rental agreement. Since this is the only case dealing directly with a lease of personal property itself, and not the space which it occupies, it would seem that the majority is limiting a lease of personal property to a fixed rental obligation, regardless of how small. The basic fact elements are the same in *Peerless* case as in the present, with the exception of the rent. It would, therefore, appear that a small fixed rental charge might have brought this agreement within the protection of the statute. The distinction thus made is a tenuous one. Property law recognizes the validity of a pure percentage lease with no fixed rental attached.[21] In the case of *Dyal v. Wimbish*[22] the court said that the consideration of $1 would be sufficient consideration for a lease; however, the

18. Memorandum of Assemblyman Savarese, the Bill's sponsor, N.Y. Legislative Annual, 1953, pp. 61-62.

19. McMichael and O'Keefe, Leases, Percentages, Short and Long Term. (1961).

20. 3 A.D.2d 249, 160 N.Y.S.2d 163 (1st Dep't 1957).

21. Dyal v. Wimbish, 124 F.2d 464 (5th Cir. 1941).

22. Ibid.

sufficiency of that consideration is not important since the lessee agreed to pay the lessor a fixed percentage of the profits if any.

The majority passed over the percentage rental in the present case by saying that there was no rental obligation whatsoever. This summary dismissal might have been occasioned by the lack of control the defendant had over the machine. To the Court the lack of control indicated that defendant was being paid for placing the machine on his premises rather than paying a percentage rent. Is this approach sound? In the *Peerless* case the owner reserved the property right in the dispensers, and the control element is the same. Therefore, we must once again return to the fixed rental obligation as the real distinction.

This writer feels that the Court should have decided the case differently. The amount of control given up in the instant situation is normal to this type of business arrangement. Sometimes the agreement refers to a loan of a dispenser or machine and sometimes to a lease. There is often a percentage sharing of the profits. Section 399 should not be so strictly construed as to apply only to business arrangements which involve a fixed financial obligation. It is true that the statute is in derogation of the common law and may be strictly construed. However, it is also remedial in nature, designed to protect the unwary and thus may be liberally construed.[23] In a statute of this nature the legislative purpose would be best fulfilled by a liberal construction. The sponsor of the bill in effect stated: "This bill seeks to protect all businessmen from fast talking sales organizations armed with booby traps which they plant in *business contracts* involving equipment rentals. . . . The automatic renewal clause was eliminated from landlord leases (see Real Property Law, 230). It should be outlawed in *business contracts* too." (Emphasis added.)[24] The essence of the statute is to protect the unwary by giving them notice of automatic renewal. True, these clauses create financial burdens and the statute seeks to prevent this, but more importantly it seeks to prevent it for the unwary. The essence of the statute is to give notice of the automatic renewal clause. Having to live with this agreement for another three years, under the conditions set forth, is as much of a burden as the few pennies a day it costs for towel or soap services. The miniscule distinctions made in this case will lead to nothing but confusion in the application of the section. It leaves us without a rule, by which we may define the curbs in this highway to the emancipation of the unwary businessman.

F. P. M.

EFFECT OF INTERSTATE COMMERCE REGULATION UPON ONE TRIP LEASE AGREEMENT

The decision of the Court of Appeals in *Leotta v. Plessinger*[25] indicates an intention on the part of the Court to hold authorized carriers of interstate commerce regulated commodities to a strict interpretation of the Commission's

23. N.Y. Statutes § 321 (McKinney).
24. N.Y. Legislative Annual, 1953, pp. 61-62.
25. 8 N.Y.2d 449, 209 N.Y.S.2d 304 (1960).