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REAL PROPERTY—LEASES—RULE AGAINST PERPETUITIES DOES NOT VOID AN ON COMPLETION LEASE WHERE THE INTEREST MUST VEST WITHIN A REASONABLE TIME WHICH IS LESS THAN TWENTY-ONE YEARS.

Wong v. DiGrazia (Cal. 1963)

Plaintiff and defendant entered into an agreement whereby defendant covenanted to build a shell structure and lease it to plaintiff, upon completion, for a period of ten years. Pursuant to this agreement plaintiff made a down payment which he later sought to recover in this action on the ground that the lease agreement violated the Rule Against Perpetuities¹ and was therefore void.² The trial court ruled for the defendant on this point and in a six-to-one decision the California Supreme Court affirmed the lower court³ holding that the Rule does not invalidate a commercial agreement where the interest must vest within a reasonable time and that period is less than twenty-one years. *Wong v. DiGrazia*, Cal. App., 35 Cal. Rptr. 241, 386 P.2d 817 (1963).

Two previous decisions on virtually the same facts confronted the court in this case. Both are of very recent vintage (1958 and 1959), but unfortunately reached diametrically opposed results. *Haggerty v. City of Oakland*,⁴ a California case, held that an "on completion" lease was void in the face of the perpetuities Rule when no other specified time for the vesting of the tenant's interest was set forth. The rationale of the case was that, since the remote possibility existed that the completion of the building might take more than the prescribed twenty-one year period, the agreement was invalid. An opposite result was reached in *Isen v. Giant Food, Inc.*,⁵ a federal case decided on similar facts. There the court held the lessee had a present vested right to possession at a future date. Since the interest had vested, it was not subject to the Rule.

1. CAL. CIV. CODE, § 715.2 (1951) provides:

No interest in real or personal property shall be good unless it must vest, if at all, not later than 21 years after some life in being at the creation of the interest and any period of gestation involved in the situation to which the limitation applies. The lives selected to govern the time of vesting must not be so numerous or so situated that evidence of their deaths is likely to be unreasonably difficult to obtain. It is intended by the enactment of this section to make effective in this State the American common-law rule against perpetuities.

2. Though the issue as to the application of the Rule Against Perpetuities was the major issue in the decision, the actual dispute between the parties which precipitated this litigation concerned the cost of installing a sprinkler system in the building. Both the trial court and the California Supreme Court found for the defendant on this issue although the trial court was reversed on the issue of damages on defendant's cross-appeal. The area of particular interest which will be examined here, however, is the perpetuities issue.

3. Justice Tobriner wrote the majority opinion with Chief Justice Gibson, and Justices Traynor, Schauer, McComb and Peek concurring, while Justice Peters, dissented.

4. 161 Cal. App. 2d 407, 326 P.2d 957 (1958).

5. 295 F.2d 136 (D.C. Cir. 1961).

Neither case was greeted with overwhelming approval. The *Haggerty* case received scathing criticism for the result it reached,⁶ while the *Isen* case was almost equally unpopular because of its rationale.⁷ The instant court was asked to reject both lines of precedent on the ground that the Rule Against Perpetuities, which was originally developed in a context of gift transactions, estate planning and family settlements, had no useful application in the area of commercial transactions. The court, however, attempted to reach the *Isen* result by announcing that the Rule Against Perpetuities would continue to apply to commercial transactions for the present at least, but that a standard of reasonableness would be grafted on to the famous prohibition in certain rather nebulous circumstances. The objectionable reasoning of the *Isen* case was thus avoided, but possibly at a high cost.

While there is certainly a wide diversity of opinion concerning how the Rule Against Perpetuities should be applied, there is an even greater diversity concerning when it is applicable. This is principally because the exact purpose of the prohibition is subject to dispute. Some authorities have held that the object of the Rule is to keep land in commerce and encourage productivity by forbidding restrictions on sales.⁸ Others contend that the Rule is designed to prevent vagueness and uncertainty in future interests.⁹ A more recent view of the Rule, which takes into account the fact that it was developed in a society much less concerned with commercial transactions in land than with family settlements, finds its justification in preventing the dead hand of the past from controlling the dispositions of the future.¹⁰ Each generation must be free to use the land and to pass it along untrammelled by restrictions placed upon it too many generations before. Legislatures and other authorities share this diversity of opinion, and reflect it in their recommendations for revision.¹¹ Whatever the purposes of the Rule, the court in the instant case admits that it was ". . . only by an overextension of nineteenth century concepts that the Rule was applied to commercial transactions."¹²

6. At least one authority feels that the result was ridiculous under any construction of the Rule. See Leach, *Perpetuities: New Absurdities, Judicial and Statutory Correctives*, 73 HARV. L. REV. 1318 (1960). Rough treatment of the case is also meted out in 37 NOTRE DAME LAW. 561 (1962).

7. 10 HASTINGS L.J. 439 (1959).

8. *Barton v. Thaw*, 246 Pa. 348, 92 Atl. 312 (1914), the famous Pennsylvania case, appears to adopt this view, but unfortunately equates the purposes behind the restraints on alienation rules with those supporting the Rule Against Perpetuities.

9. Berg, *Long Term Options and the Rule Against Perpetuities*, 37 CALIF. L. REV. 235 (1949), expounds this point of view which is apparently derived from Gray's work on the subject. See GRAY, *THE RULE AGAINST PERPETUITIES*, § 268 (4th ed. 1942).

10. Simes, *The Policy Against Perpetuities*, 103 U. PA. L. REV. 707 (1955).

11. See ABA, *LEGISLATORS' HANDBOOK ON PERPETUITIES*, App. II, III, IV (1958). "The rule has also been subjected in some states to sweeping statutory reform." *Wong v. DiGrazia*, 35 Cal. Rptr. 241, 245, 386 P.2d 817, 821. (Citing statutory changes in Idaho, Illinois, Massachusetts, Pennsylvania, Vermont and, although not governing this case, California.) *Id.* at 245, n.4, 386 P.2d at 821, n.4.

12. The court characterized the Rule as mercantilistic in its foundation, but the actual purposes of the Rule appear to have had nothing to do with that economic

This modern approach would seem to indicate that it would be advisable to discard the Rule in the area of commercial transactions and to rely on the normal rules against restraints on alienation to effect public policy.¹³ The court however finds that the Rule accomplishes a useful purpose in this area. Rejecting the reasons which were applicable when the Rule was developed in the area of family settlements, the court seeks to interpret it in a way which will give effect to the peculiar requirements of the commercial field. It therefore examines the lease in the light of contract principles, and by applying to each portion the doctrines of impossibility and frustration, concludes that the lease either would vest an interest in the lessee or be declared void within the prescribed period. Each of the four possibilities advanced by the plaintiff which might cause the interest not to be established within the required period is considered by the court and rejected as unreasonable.

The first two possibilities advanced by the plaintiff concern delays in construction of the contemplated shell building caused by one of the parties. Each is rejected on the ground that the lease on its face would forbid such delays. The lease in question called for construction of the structure forthwith, and such a clause could not under any circumstances be read as allowing a twenty-one year delay in completion.¹⁴ It is this expeditious performance clause which is crucial to the enforcement of the lease. It clearly shows the intention of the parties not to violate the Rule and indeed to have the lease not only vest, but expire well before the statutory period has run.

The other two possibilities submitted by the plaintiff concern outside occurrences which would also cause lengthy delays. These are the chances that building permits and other technical governmental requirements for construction would not be forthcoming. Once again the court brought the rule of reasonableness into play. It held that the public regulations were to be met within a reasonable time, that such a reasonable time in these circumstances must be less than twenty-one years, and that therefore the dangers against which the Rule protects are not present. In this reasoning the court relies on the previously mentioned *Isen* case which had followed this line of thought as to government regulations, but had not used it to avoid potential delays between the parties.

Another contingency which was not considered by the court, but which has been raised by other authorities, is the chance that the lessor might

policy which was formulated by the British government under the influences of the merchant classes. CLARKE, *THE LATER STUARTS* 44-46 (1944). Actually the Rule was most likely promulgated under the influence of the powerful landed class which wished more control over its own estate. TREVELYAN, *ENGLAND UNDER THE LATER STUARTS*, 50 (1941).

13. Although there is apparently no precedent for such a course in this area, there is precedent in the analogous cases involving preemptive rights to purchase. *Maynard v. Polhemus*, 74 Cal. 141, 15 Pac. 451 (1887).

14. For a case holding that five years was a reasonable time within which the holder could exercise an option see *Kirkland v. Odum*, 156 Ga. 131, 118 S.E. 706 (1923). *But see* *Bauer v. Lumaghi Coal Co.*, 209 Ill. 316, 70 N.E. 634 (1904), holding that five and one-half years was an unreasonable length of time.

breach, and the lessee might not seek to impose his rights until after twenty-one years.¹⁵ This could conceivably leave the property useless and thus violate the Rule. Under the court's reasoning, however, such an argument would seem to be ineffective. The contract to build had to be completed long before twenty-one years elapsed, and the statute of limitations would have run on the lessee's right of action. Any interest in the property on the part of the lessee would, therefore, fail before the period prescribed by the Rule. Also, if the reason for the Rule is to keep land in use, the Rule would not be violated since it is inconceivable that the owner would allow the land to lie idle, while waiting for the lessee to enforce his rights.

Justice Peters' dissenting opinion makes a two pronged attack on the reasonableness test of the majority. In his view, the Rule admits of no reasonable construction; it must be applied to void the agreement in any case where there is any possibility that the interest will not vest within the prescribed time.¹⁶ To him, reasonable probabilities are immaterial, but almost incredible possibilities are determinative. Though the majority may be criticized for even applying the Rule in this situation, it certainly reaches a more just conclusion than does the dissent. Were the dissent to prevail, no agreement of any kind to vest an interest at a future date would be valid unless it expressly stipulated that in no case could the interest vest later than twenty-one years.

The other prong of the dissent's argument and the reason he would require strict application of the Rule, is his view that the old reasons for the Rule still apply. Unfortunately Justice Peters fails to state which of the various rationales he believes is the policy behind the Rule. Running through the entire dissenting opinion, however, is a concern for certainty, so the best estimate as to his reason for the Rule is the fear of vague future interests. But even the twenty-one year period allowed under the Rule would be far too long for modern business practice. It can hardly be imagined that today's businessmen, negotiating for possession of a building rather than the land under it, are concerned with more than the few months that it takes to construct such a building and the term of years to which lessee is entitled after he takes possession.

Besides the alternatives of either completely rejecting the Rule Against Perpetuities or construing the lease as a present right to future possession,¹⁷ the court also had another avenue available, although it is doubtful it could have applied it in the absence of statutory authority. This avenue was use of the Pennsylvania wait and see doctrine.¹⁸ Under it the court could

15. *Supra* note 7, at 441.

16. The dissent also makes the point that the Rule is not one of construction which can be used to determine intention. See also *Dime Sav. & Trust Co. v. Watson*, 254 Ill. 419, 98 N.E. 777 (1912).

17. The court's rejection of the latter of these two doctrines would appear to be justified in light of the fact that such interests have been permitted in England only when the lease is to begin at the end of a prior term and not upon a contingency. *Mann, Crossman, & Paulin, Ltd. v. Registrar*, [1918] 1 Ch. 202.

18. PA. STAT. tit. 20, § 301.4(b) (1947). Under this doctrine, the court must determine the validity of a future interest upon the basis of actual and not possible

have dismissed the case since it was brought within the twenty-one year period and waited to see whether the interest would vest within the limits of the period.¹⁹ The primary objection to such a technique is that the property in dispute is hopelessly tied up while the court waits to see whether the interest is valid.²⁰ The instant decision with its reasonableness test attempts to alleviate this problem by looking at the situation as it was at the time of the agreement and by using contract principles to determine what the result of the lease must be in the future. This effectively does away with the problem of tying up the property, but all rules of construction are fallible, and the certainty of the wait and see rule is lost. This may be a necessary evil inherent in many rules of law, but it is a difficulty which could prove bothersome in certain situations.

The court adopted the rule of reasonable construction to adapt the Rule Against Perpetuities to the needs of commercial transactions, an area beyond the scope of the Rule as originally developed. The decision nevertheless raises a question whether the rule of reasonable construction is to be confined to this area, or is to be considered a rule of general application in future interest cases. Does the case foretell a general breakdown of the Rule Against Perpetuities by inviting "reasonable probability" exceptions in other areas?

Though not governing this case, the California legislature has passed several new enactments which may disclose a legislative intent favoring an affirmative answer.²¹ These new amendments prohibit holding void or voidable any interest if, and to the extent that, it can be reformed by construction to give effect to the intent of the settlor within the limits of the Rule. They extend the period to sixty years when there is no life in being, and they provide that an interest may be regarded as vested if there is a person or persons in being who can convey a fee simple title. A similar liberalizing trend is found in the statutory changes noted in other states by the court.

The liberalizing trend of the statutes in California and elsewhere remains directed to the problems of estate planning and not to the problems of commercial transactions. In general, the periods are long enough to accommodate the immediate generations of a family, but are too long when applied to options.²² Had the court discarded the Rule, no damage would

facts, thus it must wait and see whether the interest is void until the end of the period. But even before the passage of the statute, the Pennsylvania courts refused to pass upon the validity of a future interest until the end of the period. The statute improved upon this practice by making substituted gifts calculated to carry out the probable intent of the donor when, after waiting, it was found that an interest was void.

19. This would be the normal situation. However, here it would not have been necessary for the court to dismiss since, as was noted in note 2, *supra*, the court had found the plaintiff had breached in regard to the sprinkler system. The interest having thus failed within the prescribed period, the lease could not be held violative of the Rule Against Perpetuities.

20. Comment, *Applicability of the Rule Against Perpetuities to Commercial Leases*, 19 WASH. & LEE L. REV. 91 (1962).

21. CAL. CIVIL CODE, §§ 715.5-8 (Supp. 1963).

22. The "on completion" lease probably helps to make land more freely alienable rather than restricting its transfer. 47 CALIF. L. REV. 197 (1959). It has been sug-

have been done since the rules against restraints on alienation would have protected the rights of the parties.

In view of the uncertainties which the decision raises, the fact that the Rule was never designed to cover this type of transaction, and that the parties and the public policy will be fully protected without the Rule, the court should have held the Rule inapplicable to commercial transactions.

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gested that the Rule should not be considered at all in option contracts. 4 VILL. L. REV. 144 (1959). It is suggested here that it should not be considered in any commercial transaction since the protection it affords is secured by other rules, and the reasons for the rule do not apply to the situation.