Purchase Options, ROFRs, and ROFOs: Theory and Practice
or
What can a law professor tell ACREL Fellows about purchase options, rights of first refusal, and rights of first offer that they don't already know?

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An economist, an ACREL Fellow, and a law professor walk into a foreclosure sale. As soon as the successful bid is accepted, the economist announces "I have a right of first refusal on this property, and I hereby elect to exercise my right and purchase the property for the foreclosure sale price." The ACREL member objects "You must be kidding; there's been no bona fide offer to purchase in the sense intended by a right of first refusal." The law professor cautions "We'd better research whether this is a title theory jurisdiction or a lien theory jurisdiction."[1]

Introduction

Let me begin with a confession: most of what I know about these topics, I learned from ACREL Fellows.[2] Should you doubt this, check the footnotes. If I can add anything at all, it may be to offer connections between a few theoretical points relevant to these devices and a handful of practical considerations. Or sometimes to contrast the theoretical with the practical. With these modest objectives in mind, this paper highlights the role that theory can play in transactions involving purchase options ("options"), rights of first refusal ("ROFRs"), and rights of first offer ("ROFOs").

The three divisions of this paper consider property law theory and contract law theory in two practical contexts, interrupted in the middle by a few practical inquiries about the purely theoretical. Part I recaps how contract law and property law principles give rise to some of the most common issues that practicing lawyers encounter when dealing with options, ROFRS, and

[1] If you find that your recollection of mortgage theory is a bit stale, jump to the conclusion for the exciting explanation of this parable.

[2] My first practical experience with options, ROFRs, and ROFOs came in my years working under the tutelage of an outstanding mentor, Michael G. O'Flaherty, first as his associate and then as his partner. In addition to that influence, two recent publications by ACREL Fellows have especially informed this paper. *See* Joshua Stein, *It Seemed Like a Good Idea at the Time: Rights of First Offer and First Refusal*, N.Y. REAL PROP. L. J., Fall 2014, at 6; John C. Murray, *Options and Related Rights with Respect to Real Estate: An Update*, 47 REAL PROP. TR. & EST. L. J. 63 (2012). *See also* Kevin L. Shepherd, *Rights of First Refusal: Poison Pills and Bad Faith*, PROB. & PROP., May/June 2007, at 52 (focusing particularly on whether the holder of a right of first refusal must always match every term of the third-party offer that triggers the right). Several other ACREL Fellows suggested some of the cases and other resources used in this paper. Dale Whitman provided a drop box overflowing with ideas (more than 70 entries). Beat Steiner gave me a substantial starter package from his files, and Greg Stein (who alerted me to the opportunity to participate in this panel), Bill Locke, and Wilson Freyermuth, each offered other valuable resources, some that turn up in this paper and others that led less directly to ideas explored here. Finally, I am grateful to Steve Dyer, who offered helpful suggestions, comments, questions, and corrections to an earlier draft of this paper. My apologies to other ACREL Fellows who have written on these topics, as I realize there are several. Time and space limitations account for my decision concerning the scope of this paper.

ROFOs. Part II asks what practical value, if any, the law and economics literature and game theory might offer to lawyers wrestling with ROFRS, and ROFOs in practice. Finally, Part III comments on a selection of recent cases, especially ones that invoke theory—efficaciously or otherwise—to resolve practical problems.[3]

Options, ROFRs, and ROFOs all involve a grant by the owner of an interest in the subject property (the "grantor") to another (the "holder") of a right to acquire an interest in the property. For the most part, I will keep the focus on real estate transactions, although similar issues come up in several other contexts.[4] The real estate interest involved may be fee title, a leasehold, or something else, but unless a particular context requires otherwise, this paper assumes the interest is fee title. Although real estate practitioners sometimes resort to other interesting preferential rights as alternatives to ROFRs and ROFOs, this paper does not consider these other devices in detail because they appear to be much less common and are less frequently addressed by courts and legal commentators.[5]

Part I Options, ROFRS, and ROFOs under Contract and Property Law

Because so much of such excellent quality has already been written on these topics (a good deal of it by other ACREL Fellows), here I offer only a general recap of basic contract law and property law principles relevant to options, ROFRs, and ROFOs.[6] In light of this paper's interest in the theory-practice divide, the framework that the Restatement (Third) of Property (Servitudes) applies to options, ROFRs, and ROFOs offers a good place to begin. For the most part, the practice literature does not seem to give great deference to the Restatement on these topics, although a few recent cases do. Indeed, practitioners might find it surprising that the Restatement deals with these topics under the servitudes rubric. But as a matter of Restatement theory, the prototypical option, ROFR, or ROFO is a covenant encumbering the grantor's interest, and therefore is a servitude, provided that either the benefit or the burden runs with

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[3] With gratitude, I acknowledge the solid research assistance of Christopher Cooper, a third-year student, and Traci Huesing, a second-year student, both members of the research team at the University of Arkansas School of Law. Together, they skillfully summarized over 250 cases for my consideration.

[4] *See* Robert K. Wise, Andrew J. Szygenda, & Thomas F. Lillard, *First-Refusal Rights under Texas Law*, 62 BAYLOR L. REV. 433, 440-42 (2010) (explaining that first-refusal rights often appear in a wide range of contexts, including oil and gas instruments, power-generating contracts, distributorship and dealership agreements, and many others); David I. Walker, *Rethinking Rights of First Refusal*, 5 STAN. J. L. BUS. & FIN. 1, 10-13 (1999) (noting that, in addition to being used in real estate transactions, ROFRs often appear in agreements among corporate shareholders and other business venturers, production contracts for commercial products, employment agreements, and franchising arrangements). Contracts in the entertainment industry also sometimes include ROFRs or ROFOs. *See* Brit Grosskopf & Alvin E. Roth, *If You Are Offered the Right of First Refusal, Should You Accept? An Investigation of Contract Design*, 65 GAMES AND ECON. BEHAV. 176 (2009), http://nrs.harvard.edu/urn-3:HUL.InstRepos:4261988.

[5] Other devices include a right of last refusal and a right of first negotiation. *See generally*, Murray, *supra* note 2, at 68-76; Walker, *supra* note 4, at 8-11. *Jeremy's Ale House Also, Inc. v. Joselyn Luchnick Irrevocable Trust*, 22 A.D.3d 6, 798 N.Y.S.2d 416 (2005), discussed at the end of the ROFR section of part III *infra*, involves a right of last refusal.

[6] Jack Murray offers a good start for readers who may be interested in some of the leading resources. Murray, *supra* note 2, at 70-75. Additionally, Beat Steiner's Program Overview paper for this panel provides an extensive list of resources.

land.[7] Under the Restatement, the formalities required to create a servitude are essentially the same as those required to create an estate in land, which means that the Statute of Frauds governs unless some established exception applies.[8] Additionally, servitudes are subject to the Restatement's rules relating to restraints on alienation.[9]

As a practical matter, even if you are comfortable with the general notion that these principles apply to options, ROFRs, and ROFOs, I'll venture a guess that you've not recently commented to a colleague, "Our client may want to acquire this property at some time in the future; let's see if we can negotiate a servitude." That, however, is how a theorist steeped in the Restatement might put it. With this theoretical background in mind, the discussion below highlights the relevant aspects of the Restatement.

Purchase Options

As a matter of contract law, a purchase option is a one-sided contractual device by which the grantor makes a binding offer to sell the property to the holder.[10] For a more or less fixed time, an option imposes a legal obligation on the grantor to transfer the subject property to the holder. It gives the holder an enforceable right to purchase the property, but it does not obligate the holder to purchase nor, in the usual case, does an option bind the holder to any other obligations, unless and until the holder elects to convert the offer to sell into a purchase and sale agreement. During the term that the option is in effect, at least where the holder has given adequate consideration, the grantor's offer is irrevocable. For that reason, every option agreement should clearly define the duration of the holder's rights.

Most recurring legal issues surrounding options involve well-settled legal principles. As a matter of contract law, because an option obligates the grantor to sell if the holder exercises the right, an option establishes an irrevocable offer to sell during the specified term only if it is supported by sufficient consideration.[11] An agreement granting an option is one concerning the conveyance of an interest in real estate and therefore generally must satisfy the Statute of Frauds.[12]

To transform an option into a contract of purchase and sale, the holder must accept the offer by a proper exercise of the option.[13] This typically means taking precise steps specified by the document creating the option. The exercise must be timely, and it must conform to any other

[7] *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 1.1 & 1.3 (AM. LAW INST. 2000) [referred to throughout this paper as "the Restatement" or "RESTATEMENT." Although other divisions of the Restatement also have something to say about options, ROFRs, and ROFOs in some limited contexts, those contexts are beyond the scope of this paper. The Restatement provisions considered in this paper apply generally to easements, profits, and covenants that run with land; options, ROFRs, and ROFOs are categorized as covenants and are subject to the Restatement principles discussed in the text, except to the extent that certain special considerations apply to covenants in leases or mortgages. *See Id*. § 1.1 (a) & (b).
[8] *Id*. §§ 2.1 & 2.7.
[9] *See generally id.* § 3.4.
[10] *See, e.g.*, Steiner v. Thexton, 48 Cal. 4th 411, 418, 226 P.3d 359, 364 (2010).
[11] *See, e.g., id*. at 420, 226 P.3d 359 at 365.
[12] *See, e.g.,* Pardee v. Jolly, 163 Wash. 2d 558, 567, 182 P.3d 967, 972 (2008).
[13] *See, e.g.,* Foye v. Parker, 15 A.D.3d 907, 907, 790 N.Y.S.2d 787, 788 (2005).

specified requirements concerning how and to whom a notice of exercise is to be given. Further, because the holder's exercise of an option creates an enforceable purchase and sale contract, the option must include the materials terms of the deal.[14] Particularly from the holder's perspective, these legal issues militate in favor of a comprehensive written agreement that unambiguously sets out the timeframe and procedures for exercising the option and that includes all of the material terms of the resulting contract.

For these reasons, the option agreement or other governing document typically provides for actual, monetary consideration for the grant and includes all of the terms that will come into effect as the contract of purchase and sale agreement once the holder exercises the option. Contemporary practices for incorporating the material terms of the prospective purchase and sale agreement into the option seem to vary from one jurisdiction to another. Attaching a complete copy of the purchase and sale agreement is a prudent method.[15] In that way, the parties avoid disagreements over the terms of the deal after exercise, and the holder, in particular, precludes any argument over the enforceability of the option based on the principle that a contract must include all material terms of the agreement. But in locations where standard contract forms are used for certain property types, an acceptable shortcut is possible by specifying that the parties will execute the standard form.[16] A riskier approach is for the option agreement to state only those terms the parties consider material, with an express or implied agreement that open terms must conform to standard practices.[17]

The two most theoretical issues that come up frequently in the literature as well as in the cases involve the application of the Rule Against Perpetuities (the "RAP") and the rule against unreasonable restraints on alienation. As part III of this paper demonstrates, disagreement persists about the extent to which these rules apply. Depending on how receptive the courts of the relevant jurisdiction are to adopting Restatement positions, lawyers involved in disputed cases may find some practical help in theory as declared by the Restatement. Section 3.3 of the Restatement bluntly provides that the RAP does not apply to servitudes, and thus cannot be a basis for voiding an option. Rather, the Restatement provides that challenges based on the time period during which option rights may be exercised are analyzed under the rule governing direct restraints on alienation, which requires reasonableness under the circumstances. The following excerpt from a comment to Section 3.4 summarizes the most important considerations of the Restatement's rule relating to restraints on alienation as applied to garden variety options to purchase:

> *e*. *Options.* The reasonableness of an option in gross to purchase land is determined by the duration of the option and the price. If the price is set at fair market value when the option is exercised, the practical effect of the restraint is much less than if the price is fixed, and a longer duration is justifiable. If the price is fixed, the effect of the option is to discourage improvement of the land, and the option is unreasonable unless its duration is

[14] *See, e.g.,* Creely v. Hosemann, 910 So. 2d 512, 520 (Miss. 2005).
[15] *See, e.g.*, LaRoche v. Nehama, 979 So. 2d 1021, 1022 (Fla. Dist. Ct. App. 2008).
[16] *See, e.g.,* Elderkin v. Carroll, 403 Md. 343, 348, 941 A.2d 1127, 1130 (2008) (option agreement called for a "standard contract").
[17] *See, e.g.,* Creely v. Hosemann, 910 So. 2d 512, 520 (Miss. 2005).

> specified. Even if the duration is specified, an option for a lengthy period may be unreasonable unless the length is justified by the purpose, or unless it is clear that the parties expressly bargained over the specified duration. If the duration is not specified, an option terminates after a reasonable time under rules stated in §§ 4.3 and 7.2.[18]

A real estate option is "in gross" if it is transferrable but not appurtenant to some other real estate interest owned by the holder.[19] Also, the Restatement provides that if the option agreement does not specify the length of time the holder has to exercise the right, a term is implied that an option in gross will last for a reasonable time.[20]

Another largely theoretical question is whether an option is transferrable if the party's intent is not clear from terms of the option agreement. The Restatement declares that a servitude (and therefore an option) is generally transferrable if it is not personal.[21]

One more basic, theoretical issue continues to pop up in the cases—the extent to which the jurisdiction's recording act applies to the holder's interest under an option. On this point, by virtue of categorizing options as servitudes, the Restatement generally contemplates that the recording act applies.[22]

Rights of First Refusal

In contrast to an option, a ROFR is not an offer by the grantor to sell the property. At a most basic level, a ROFR restricts the grantor's future freedom to sell the property during the term of the ROFR, and it gives the holder the opportunity to acquire the property in preference to any third-party should the grantor wish to sell.[23] A ROFR creates some contract rights and burdens relating to the property, but the characteristics of those rights and burdens can vary significantly based on the parties' intent and the precise language they use to create the ROFR. Indeed, to resolve the many challenging issues that even a routine ROFR presents, a properly

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[18] RESTATEMENT, *supra* note 7, § 3.4.

[19] *Id*. § 4.5. The comments to Section 3.4 do not offer any special guidance of general application concerning the reasonableness of an option that is appurtenant to an interest in real estate rather than in gross. The comments do specifically address two situations that would often involve appurtenant options. First, the reasonableness of an option in favor of owners in a common ownership regime, such as under a property owners' declaration "is determined by the circumstances, including the price and the terms for exercise." *Id.* § 3.4 cmt. e. Second, the same comment provides that an option "to repurchase in the event the property is not developed within a particular period of time may also be reasonable, depending on the price, duration, and other circumstances." *Id*. Apparently, the Restatement intends to leave most questions about the reasonableness of appurtenant options to the broad rule of Section 3.4, which calls for reasonableness to be determined "by weighing the utility of the restraint against the injurious consequences of enforcing the restraint." Note that the duration of an option appurtenant to a leasehold would ordinarily be coterminous with the leasehold and would be subject primarily to the law of landlord and tenant rather than the law of servitudes. *See, e.g., id.* § 4.3.

[20] *Id*. § 4.3. Recall, however, that certain special considerations apply to options created in leases. *See id*. § 4.3 cmt. c. *See also supra* note 7.

[21] *Id*. § 4.6.

[22] *See generally id*. §§ 7.14-.16.

[23] *See, e.g.*, Anderson v. Parker, 351 S.W.3d 827, 831 (Mo. Ct. App. 2011) (discussing the distinctions between an option and a ROFR); Bayer v. Showmotion, Inc., 292 Conn. 381, 407-08, 973 A.2d 1229, 126 (2009) (explaining the distinction between an option and a ROFR and holding that once the grantor notified the holder of an acceptable third-party offer the ROFR ripened into an option to purchase).

drafted ROFR agreement requires extraordinary attention to a host of details, both theoretical and practical.[24]

The classic ROFR empowers the holder to accept what is in effect, if not in form, an irrevocable offer from the grantor at a future time to sell the property to the holder on terms acceptable to the grantor, as defined by the material terms of a third-party offer that the grantor is willing to accept.[25] The event that triggers the holder's right is a third-party offer that the grantor finds acceptable. The grantor's notice of the third-party offer functionally becomes the grantor's offer to transfer the property to the holder on those same terms. Because the grantor's offer at that point is irrevocable for the period established for the holder's exercise under the terms of the ROFR agreement, the grantor's notice essentially converts the ROFR to an option in the holder to purchase.

In this more or less standard version of a ROFR, the phrase *right of first refusal* recognizes that the grantor may not sell to the third-party unless the holder refuses to enter into a contract to purchase the property on the terms proposed by the third party. Once the right is triggered, if the holder exercises it, the parties enter into a purchase and sale agreement on the specified terms, and if the grantor will not execute an agreement on those terms, the holder is generally entitled to specific performance.[26] If the holder declines to exercise the right, the grantor is free to sell the property to the third-party offeror (and perhaps to anyone else) on those terms but not on terms that are less favorable (or sometimes *materially* less favorable) to the grantor. From one jurisdiction to another, the cases characterize the interest that a ROFR creates in different ways. Under the Restatement, of course, a ROFR constitutes a servitude burdening the grantor's title.[27]

The ROFR agreement normally designates the duration of the right, the manner in which the grantor must notify the holder of the opportunity, the length of time the holder has to exercise the right after receiving the notice, and the process the holder must follow to exercise the right. More comprehensive ROFR agreements address many other contingencies and nuances, including what specific events and circumstances will or will not trigger the right, whether the holder's exercise may deviate in certain respects from the terms of the third party offer, whether and under what circumstances the grantor may sell the property to someone other than the specified third party if the holder does not exercise the right, whether the holder's right will

[24] *See* Joshua Stein, *Model Right of First Offer*, N.Y. REAL PROP. L. J., Fall 2014, at 20.
[25] *See* John C. Murray, *supra* note 2, at 70. Standard definitions of a ROFR do not necessarily speak of the holder having a right to accept an offer from the grantor to sell, probably because the terms of ROFR agreements usually do not characterize the grantor's notice to the holder as an offer to sell; more commonly, perhaps, definitions explain that a ROFR, once triggered by a third-party offer acceptable to the grantor, gives rise to a right in the holder to purchase the property on those terms. For the purposes of this paper, however, I prefer characterizing a ROFR as the right to decline or accept an offer that the grantor may make to the holder in the future, because I find it more in keeping with aspects of contract and property law theory highlighted in this paper, especially as viewed from the Restatement perspective.
[26] *See, e.g.*, Jarvis v. Peltier, 400 S.W.3d 644 (Tex. App. 2013).
[27] *See supra* notes 7-9 and accompanying text.

survive if the holder declines to exercise the right but the deal with the third party does not close, and more.[28]

Because property owners and prospective buyers use ROFRs in a wide range of situations and then must live with them at a future time when the circumstances may be much different from what they anticipated, a lawyer advising a client who is a party to a ROFR or who is interested in the property as a prospective third-party buyer must be extremely careful to examine both the precise terms of the document that establishes the ROFR and the nuances of the governing jurisdiction's law. The theoretical issues that arise include, to name the most common ones, whether or how the RAP, the rule concerning illegal restraints on alienation, the Statute of Frauds, recording acts, the relation back doctrine, Article 9 of the UCC, and assignability principles apply to the ROFR.[29] On the more practical end of the spectrum, as the cases noted in part III of this paper illustrate, legal disputes commonly arise over such issues as:

- What does it mean for the holder to have the right to match the third party offer if the offer includes more or less property than the ROFR covers, as in the case of a proposed package deal, bulk sale, or proposed subdivision?
- What is to be done about unique terms in the third party offer that the holder either cannot precisely match or that the holder may logically view as infeasible or illogical to match, such as when the proposed transaction involves the transfer of stock or other equity interests, or the price is based on special financing terms?
- Must the holder exactly match a third-party offer or may the holder effectively exercise the right by offering economically comparable terms?
- Does a proposed gift transaction, an estate planning transfer, a transfer among family members or co-owners, a business restructuring transaction, a co-tenant's partition action, a change in control of the entity that owns the property, a condemnation action, a foreclosure, or deed in lieu of foreclosure trigger a ROFR?
- May the holder ignore some terms of the third party offer on the grounds that they are immaterial?

Countless cases over the years address these and similar issues, all too often reaching inconsistent or confounding results.[30] Even when courts agree on the governing legal principles, disputed and complex facts make it extremely risky to predict results.

Does the Restatement help to sort out the contested issues? For most purposes, the Restatement expressly applies the same principles to ROFRs as it does to options (each being treated as an alternative device for creating a servitude). For those jurisdictions inclined to follow its rules, the Restatement resolves a few basic issues, especially the most theoretical ones, but it

[28] *See* Stein, *supra* note 2, at 14-15 (providing an extensive list of drafting points; Murray, *supra* note 2, at 65-68 (discussing the importance of clear and comprehensive drafting) & App. B & C (sample ROFR agreements). Beat Steiner has also provided a comprehensive drafting checklist in his Program Overview for this panel.
[29] One other issue that might be included in this list—but one that this paper does not address at all—is the impact of bankruptcy on ROFRs (as well as on options and ROFOs). *See* Murray, *supra* note 2, at 107-15.
[30] *See generally id*., at 77-91.

does not address how its broad principles apply to many of the situations that repeatedly arise in practice. In other words, the Restatement contributes more to theory than to practice.

To begin with, the Restatement excludes ROFRs from the Rule Against Perpetuities.[31] On the related rule concerning illegal restraints on alienation, the Restatement adheres in general to the common law standard of reasonableness.[32] But if the parties do not explicitly state the duration of a ROFR, the Restatement implies a term that the ROFR will continue only for a reasonable time, thereby sidestepping concerns about indeterminate restraints.[33] Once the triggering event has occurred, the Restatement considers the ROFR to be converted to an option, and thus the same considerations applicable to options apply at that point.[34] Unless the benefit of a ROFR is personal, the right is generally transferrable.[35] If a ROFR is particularly beneficial to land that the holder owns at the time the ROFR is granted, then under Section 4.5 of the Restatement, the ROFR runs with that land and is not assignable in gross.[36]

Perhaps the Restatement's most significant analytic contribution relating to ROFRs concerns illegal restraints on alienation. As applied to ROFRs, the general principle is that validity under the rule "depends on the legitimacy of the purpose, the price at which the holder may purchase the land, and the procedures for exercising the right."[37] Beyond this rather vague guidance, the comments to the Restatement advance the proposition that a typical ROFR ordinarily imposes such a modest restraint on alienation (presumably, because the grantor remains free to market the property at any time) that the duration of the right should rarely affect validity. Indeed, ROFRs "of indefinite duration may be valid, but once they trigger an option to purchase, the duration of the option must be limited to avoid invalidation as an unreasonable restraint on alienation."[38] Importantly, this relaxed principle concerns the duration of the ROFR and not the length of time the holder has to decide whether or not to exercise the right after the triggering event occurs. That is, an indefinite time during which the ROFR survives may be acceptable, but a long or indefinite duration for exercising the option that results when the right is triggered is a different matter. This attitude toward ROFRs seems practically to create a presumption against almost any claim that a ROFRs itself is an illegal restraint on alienation. Yet in some other respects, the Restatement's perspective on unreasonable restraints may mandate relatively deep scrutiny of the context of a ROFR.

The following extended excerpt from the most relevant comment demonstrates these nuances:

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[31] RESTATEMENT, *supra* note 7, § 3.3 cmt. a.
[32] *Id.* § 3.4 cmt. b.
[33] *Id.* § 4.3 cmt. c.
[34] *Id*.
[35] RESTATEMENT, *supra* note 7, § 4.6.
[36] *See id*. § 4.5; Nature Conservancy of Wisconsin, Inc. v. Altnau, 2008 WI App 115, 313 Wis.2d 382, 756 N.W.2d 641. The Restatement does not require use of any specific language to make a ROFR run with the land. *See generally* RESTATEMENT, *supra* note 7, § 5.2.
[37] RESTATEMENT, *supra* note 7, § 3.4 cmt. f.
[38] *Id*. § 4.3 cmt. c.

> If the right to purchase is on the same terms and conditions as the owner may receive from a third party, if the procedures for exercising the right are clear, and if the period within which it must be exercised is relatively short, the right of first refusal is valid unless the purpose is not legitimate. Since the practical effect of the restraint on alienability is minimal, duration of the first-refusal right should not affect validity.
>
> If the price at which the right of first refusal may be exercised is fixed, either absolutely, or by reference to a formula, the impact on alienability is greater than if the seller will get the same price whether or not the right is exercised. Stronger justification is required. The duration of such a restraint may be important in determining its reasonableness.
>
> The provisions governing exercise of the right of first refusal are important in determining its impact on alienability. Lack of clarity may cause substantial harm by making it difficult to obtain financing and exposing potential buyers to threats of litigation. Lengthy periods for exercise of rights of first refusal will also substantially affect alienability of the property. Potential buyers will be deterred by the possibility that they may not know for a lengthy period of time whether they will obtain the property or be obligated to pay the price. The risks of change in their needs and in financial markets will be greater than most buyers will be willing to accept. Strong justification would be required to conclude that any right of first refusal that imposed vague procedures or long waiting periods was not an unreasonable restraint on alienation.[39]

The policy underlying the Restatement's analysis aims to regulate ROFRs that literally impair the freedom to transfer property, but apparently not those that merely make marketing more difficult. The stated justifications, while logical in theory, arguably conflict with practical considerations. Perhaps in theory the facts that the ROFR's terms are unambiguous and that the holder must decide quickly whether or not to match the prospective buyer's offer arguably assure that the ROFR will not materially impair transactions, however, the ROFR's adverse impact on a future transfer may be significant in practice. As suggested in part III of this paper, experience seems to indicate that almost any ROFR can increase the risk of litigation. Furthermore, both intuition informed by experience and economic analysis backed by research (as discussed in part II of this paper) recognize that ROFRs have the inherent potential to deter prospective buyers, who might decide against investing time and resources to negotiate a deal and to investigate a property in the face of a preemptive right. Perhaps the justification for the Restatement's approach derives from the view that a property owner who agrees to a typical ROFR has

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[39] *Id*. § 3.4 cmt. f. Neither the comment nor the related illustrations clarify whether the reference to a right to purchase at a fixed price contemplates the unusual situation in which the terms of a ROFR specify upfront what the price (or pricing formula) will be if the holder exercises the right, but that situation apparently is what that portion of the comment addresses. For a case involving a ROFR that used a formula for determining the purchase price, see Huntington National Bank v. Cornelius, 80 A.D.3d 245, 914 N.Y.S.2d 327 (2010), and for one involving a preferential right that provided for a fixed purchase price and that the court arguably mischaracterized as a ROFR, see *National City Bank v. Welch*, 2010-Ohio-2981, 188 Ohio App. 3d 641, 648, 936 N.E.2d 539 (where the deed establishing the right at issue provided that the holder could force a sale of the property at the specified price after the death of the surviving grantee under the deed). For reasons unrelated to the pricing terms, both of these cases are discussed briefly in part III, *infra*.

presumably determined that the benefits of granting the right, usually to facilitate a present transaction, outweigh the future burdens on marketability.

Part III of this paper highlights several relatively recent cases that address many of the issues that ROFRs present. Those cases show that the fundamental legal issues relating to ROFRs either remain inadequately resolved or are sufficiently complex to produce a level of litigation that seems inordinate in the context of routine real estate transactions. To the extent that is true, parties who enter into ROFR agreements expose themselves to an unusually high risk of future disputes, especially if the agreements are not drafted and managed by experienced counsel.

Rights of First Offer

A ROFO, like a ROFR, restricts the grantor's future freedom to sell the property during the term of the ROFR, and it gives the holder a contractual preference to acquire the property if the grantor wishes to sell during the term of the ROFO.[40] Just like a ROFR, a ROFO is not an offer by the grantor to sell the property. Courts, real estate investors, economists, and attorneys do not always clearly distinguish ROFOs from ROFRs. As used in this paper, a ROFO differs from a ROFR primarily because a ROFO leaves it to the grantor, or under an alternative structure to the holder, rather than to a third-party, to specify the terms of the offer. If the grantor wishes to consider selling the property during the term of the ROFO, the grantor must notify the holder, who then has the opportunity to accept the grantor's terms or, in the alternative version, to make the first offer. While the practice literature commonly refers both to the grantor offer structure and to the holder offer variation of the ROFO, I found it interesting that all of the recent ROFO cases I reviewed involved ROFO provisions that required the grantor, not the holder, to make the offer once the grantor gave notice of the desire to sell. As part II indicates, an economic analysis might conclude that these two variations on ROFOs influence the behavior of the parties and prospective third-party purchasers in significantly different ways.

In either variation, if the grantor and the holder agree on the terms offered, they enter into a purchase and sale agreement on that basis. If not, the ROFO generally allows the grantor to market the property, but only on terms that are *the same as the first offer or at least not materially less favorable to the grantor*. As is the case with ROFRs, in practice the terms of ROFOs vary significantly from transaction to transaction.

ROFOs can present issues similar to those noted above for ROFRs, and attorneys face many of the same negotiating and drafting challenges.[41] ROFOs, however, avoid one issue that comes up regularly with respect to ROFRs: because the terms of the proposed deal are established before the grantor markets the property, a ROFO avoids the common ROFR dispute involving whether the holder must match unique or unanticipated terms of an offer proposed by a third party. Of course, the mirror image problem can arise when the holder and the grantor do not come to terms over the first offer and the holder subsequently accepts a third-party offer with unique terms that are difficult to compare to the first offer. There are far fewer recent cases

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[40] *See* Murray, *supra* note 2, at 76.
[41] *See* Stein, *supra* note 24.

involving ROFOs than there are cases involving ROFRs. Perhaps this is due to the somewhat less risky structure of ROFOs, although it may be that ROFOs simply are less commonly used than ROFRs.

The Restatement does not expressly distinguish between ROFRs and ROFOs, treating both under the broad category of servitudes. Presumably, the Restatement's rules relating to the Rule Against Perpetuities, restraints on alienation, the Statute of Frauds, and other basic principles apply equally to ROFRs and ROFOs.

Part II Options, ROFRs, and ROFOs in the Law and Economics Literature

Economists and game theorists evince a fascination with many aspects of contract and property law theory and transactions. In the same vein, contract and property law scholars tend to reciprocate by promoting an economic analysis of many legal principles. Some of the law and economics literature examines options, ROFRS, and ROFOs in ways that at times confirm and at other times challenge what may be conventional wisdom for real estate lawyers. In this part, I briefly review three economic studies, and I ask what practical implications, if any, we might hope to draw from this largely theoretical research.[42]

The economists behind these studies concern themselves with preemptive rights in general, not exclusively or even primarily in the context of the real estate industry. Some of the work is empirical, but the studies involved are highly stylized and not necessarily representative of real world transactions. I am far too deficient in economic theory and methods (and often in the mathematics of the proffered proofs) to provide a critical assessment of these studies. Accordingly, in this brief review I am reduced to restating a few of the general findings and speculating modestly about the potential implications for the real estate practitioner.

One relatively broad ranging economic analysis of ROFRs reaches conclusions that comport in at least two important respects with the experience of real estate lawyers and their clients. The first is that ROFRs "produce negotiating, drafting and dispute related costs," and the second is that they tend to discourage third-party offers.[43] The author provides an extended discussion of the latter point, and lays out the mathematics involved simply enough for even the casual reader of economic analysis to follow. Not only does this study support the practitioner's instinct that ROFRs can create benefits for holders at potentially significant costs to grantors, but it goes on to argue that a ROFR can "decrease the expected realization from the sale of the property."[44] In other words, an aggregate or net cost-benefit calculation—typically of far greater interest to an economist than to a transactional lawyer representing a single party—could show, under certain conditions, that the costs a ROFR imposes on the participants in a transaction more than offset its benefits.[45]

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[42] My thanks to Beat Steiner, the organizer and moderator of the panel discussion for which this paper has been written, for directing me to each of the three articles discussed in this part.
[43] Walker, *supra* note 4, at 15-20.
[44] *Id*. at 14.
[45] *Id*. at 14-27.

Although this study considers ROFRs in a wide range of situations, including in real estate transactions, the author primarily analyzes ROFRs as they commonly appear in agreements among stakeholders in closely held business organizations. While this limits the utility of this particular study for our purposes, several of its implications deserve our attention:

- A ROFR "dissuades third parties from participating," especially in situations in which the third party must incur significant investigation and negotiation costs to formulate an offer and where the third party cannot easily estimate the holder's valuation.[46]
- A grantor should logically resist a ROFR except if the grantor can extract offsetting value in some other way, such as via the holder's concessions in a related transaction giving rise to the ROFR .[47]
- A grantor may prefer a ROFO to a ROFR because the former device bypasses some of the negative impacts on potential third-party bidders, but a ROFO is an inferior alternative for the holder because it is now the holder rather than the third party who (if the ROFO provides for the holder to make the offer) "must calculate a single bid that maximizes his expected return in an information vacuum" or (if the ROFO provides for the grantor to make the offer) must evaluate the offer under similarly disadvantageous circumstances.[48]
- Particularly if the motivation for the ROFR is to reduce the risk of a future bargaining breakdown between the grantor and the holder if and when the grantor wishes to sell, a more efficient alternative may be available to the parties via a binding commitment made by the grantor to the holder that if the grantor wishes to sell the property during the term of the commitment, it will do so by an auction.[49] The analysis indicates that an auction avoids the costs that ROFRs impose on sellers and prospective third-party bidders and yet still affords the holder a fair opportunity to purchase. Holders will continue to prefer ROFRs if they can secure them without making significant concessions *ex ante*, but on an aggregate basis, taking into account the costs and benefits of the arrangement to all the parties, a binding commitment to auction might, at least in theory, provide the better net result.
- Even if an economic analysis demonstrates that a commitment to auction or some other alternative is better than a ROFR, in practice in many contexts, including in real estate transactions, parties are likely to continue using ROFRs based on such considerations as standardized contracting practices, established legal precedents, and the familiarity of ROFRs.[50]

A more limited economic investigation published in 2009 analyzes the device that this paper and most real estate practitioners label a ROFO, although the authors of the study, for their purposes, do not distinguish ROFRs and ROFOs and generally refer to the arrangement as a first

[46] *Id*.
[47] *Id*. at 25-26, 48-50.
[48] *Id*. at 39.
[49] *Id*. at 40-43.
[50] *Id*. at 50-52.

refusal right.[51] Employing game theory methodology, the authors conclude that at least in certain highly stylized circumstances, a preferential right is of no benefit to the holder and will even work against the holder. My admittedly oversimplified explanation of the analysis is that, under a ROFO, the grantor's first offer (and probably even more significantly, the grantor's last offer in initial negotiations with the holder) need not be at a price that is particularly favorable to the holder because (1) the grantor has the option to seek an agreement with a third-party buyer on those same terms if the holder rejects the offer, (2) a motivated third-party will be influenced by the knowledge that the holder can preempt any offer that is less favorable to the grantor, and (3) the holder will logically take points (1) and (2) into account in deciding whether to accept or reject the grantor's offer in the first instance. In theory, although not necessarily in practice, the holder should perceive any marginally acceptable offer as an ultimatum made credible by the threat that the grantor will take the deal to the third party if the holder rejects.

The predictive value of this analysis, however, is much greater in the game version than it would be in a normal real estate transaction. In the first place, the negotiating references giving rise to this study were not commercial real estate deals but situations sometimes encountered in entertainment contracts and in other settings quite distinct from the commercial real estate industry. Moreover, the utility of the analysis for our purposes is dubious because its logic relies heavily on variations of a bargaining structure—the ultimatum game—that do not comport well with any kind of circumstance familiar to real estate lawyers.[52] In particular, in the game setting, a third-party buyer: (1) is standing by waiting for the grantor to give up on making a deal with the holder; (2) has no prospect for any kind of beneficial alternative other than to make a deal with the grantor; and (3) if given the chance to play the game (i.e., if the holder rejects an offer) will incur no cost by accepting whatever offer the grantor makes that cannot be preempted by the holder. Perhaps the main practical significance of the study, especially for those of us not immersed in game theory, is that it may help explain why ROFRs seem to dominate over ROFOs in real estate transactions, where the terms of a preferential right to purchase tend to be proposed by, and for the primary benefit of, the holder. Perhaps would-be holders instinctively recognize that a triggering offer the grantor makes will generally be less favorable to the holder than one that a prospective third-party buyer makes.

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[51] Grosskopf & Roth, *supra* note 4.

[52] In the simplest two-player application of the ultimatum game, a researcher gives the first player the right to propose to the second player a division of a quantity of value belonging to neither player (e.g., the researcher supplies money or tokens for the game), and the second player has the choice either to accept or reject the offer. If the second player accepts, the value is divided between the players as the first player proposed. If the second player rejects, both players take nothing. Economic logic suggests that in this situation, the second player will rationally accept any positive value that the first player proposes because something is better than nothing. Thus, if $10 is to be divided, the second player will accept $1.00, allowing the first player to receive 90% of the value. Behavioral studies of the ultimatum game have long shown, however, that actual accepted offers tend to be much more favorable to player 2. *See id*. at 7-9. The simple explanation for this "irrational" phenomenon is that a sense of fairness comes into play.

A more recent economic study analyzes both ROFRs and ROFOs.[53] The study claims to be the only economic analysis to compare ROFRs and ROFOs. The methodology is dense with mathematics, which will make it difficult for most lawyers (and law professors) to derive much practical use from the analysis. The authors' overall conclusions, however, are easy enough to summarize.

First, they find that an array of factors determines whether these preferential rights will generate a positive surplus in joint profits for the participants (referring to the net surplus that a transaction generates in an economic sense, not that each party is necessarily better off). Among the relevant considerations, quite logically, are "the type of right, buyers' valuation distribution, buyers' investigation costs, and the number of buyers, and the cost of delay."[54] Buyers' investigations costs, especially when they are relatively high and the holder's investigation costs are lower than those that other buyers will incur, are especially important in certain circumstances.[55] The fact that holders often have significantly lower investigation costs than third-party buyers when the holder and the grantor have a prior relationship helps explain why we often see preferential purchase rights in certain settings, such as with long-term leases and in transactions in which a right concerning a parcel is incidental to the purchase and sale of a parcel in the same development.[56]

The analysis also confirms the intuition that a ROFR tends to discourage third-party participation.[57] Additionally, it concludes that a ROFR may induce the grantor to make a lower offer to a prospective third-party buyer than the grantor would make in the absence of a ROFR.[58] The apparent (and admittedly simplified) explanation for this result seems to be that if a prospective buyer knows that the holder can preempt acceptance of any offer the grantor makes, the prospective buyer will calculate a lower probability of purchasing the property and, for that reason, might not be willing to incur investigation or due diligence costs unless the price the grantor offers is lower than a price that would be attractive in the absence of an outstanding ROFR. From the perspective of the real estate practitioner, however, perhaps the most significant conclusion from the analysis is the not surprising one that both ROFRs and ROFOs tend to reduce the grantor's expected profits in comparison to situations not involving any first purchase right.[59]

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[53] Marcel Kahan, Shmuel Leshem, & Rangarajan K. Sundaram, *First-Purchase Rights: Rights of First Refusal and Rights of First Offer*, 14 AMER. L. & ECON. REV. 331 (2012). The study always assumes that in a ROFO the grantor, not the holder, must propose the terms of the first offer.
[54] *Id*. at 335. The phrase "buyers' valuation distribution" will be more familiar and meaningful to mathematicians, economists, and game theorists than to lawyers. My understanding is that when the authors of this article use the phrase in this context they are taking into account that if there are multiple potential buyers for an asset, members of the prospective buyer group will likely calculate different values for the asset within some rational range of values (e.g., there may be 5 potential buyers at $1,000,000, but only 2 at $1,100,000, and 1 at $1,150,000).
[55] *Id*. at 333-34, 357, 363.
[56] *Id*. at 353, 359.
[57] *Id*. at 349, 365.
[58] *Id*. at 333, 349.
[59] *Id*. at 347, 354.

The authors note that their study does not justify "any general conclusions on the *relative* positive surplus generated by" a ROFR and a ROFO.[60] The sharpest distinction they offer in this regard may be significant to an economist or even to a theoretical legal scholar, but it hardly seems important for practical purposes. The observation, however, will serve as a fitting conclusion to this inquiry into what an economic analysis may tell us about ROFRs and ROFOs. Here it is, for whatever practical value it may have: when the holder's and the third-party buyers' investigation costs are identical, a ROFR "always generates more surplus" than a ROFO.[61]

Part III A Sampling of Recent Cases

As mentioned at the beginning this paper, the cases discussed here are all relatively recent. They were decided within the past 10 years or so; but I am not providing a comprehensive annotation of the reported cases for that time period. Rather, I have selected some of these cases because they nicely illustrate common issues, others because they venture somewhat beyond well-settled principles, and the rest simply because they are quirky, surprising, entertaining, or otherwise especially interesting. Among other things, these cases demonstrate that options, ROFRs, and ROFOs continue to give rise to significant disputes, often in ways the parties never anticipated.

Part I of this paper noted that cases involving options tend to apply fairly well-established legal principles to poorly drafted option agreements or novel situations. And, as was also mentioned in Part I, there are relatively few recent cases involving ROFOs. The majority of the cases discussed in this part, as well as many of the most significant and interesting ones, therefore, arise out of ROFRs. In the end, I have chosen to highlight the cases from my research that caught my fancy, and I hope some of them will attract yours as well.

Option cases

One of the most basic issues concerning an option is whether it creates an interest in land or only contract rights. In an odd case that turned on which statute of limitations applied to the claim, a California Court of Appeal rejected an option holders' argument to apply the statute of limitations governing claims of an injury to real property. The court reasoned that "an option to purchase real property is a contractual right" and that it is only by exercising the option that the holder owns "an interest in real property which can be injured."[62] The plaintiffs' claim at issue in the appeal was not for breach or enforcement of the option agreement, but stemmed from allegations that the plaintiffs (including both the original option holder and assignees of the original holder) suffered damages due to other options the grantors (the McGovrans) gave to a lender at the lender's insistence. The McGovrans granted the options to the lender while the options that the plaintiffs claimed under were still in effect. The plaintiffs argued that the lender's options conflicted with the plaintiff's rights and clouded title to the property because the lender's options were exercisable if escrow on certain options held by plaintiffs failed to close by dates that were more than three months earlier than the deadlines specified in the option

[60] *Id*. at 363 (emphasis in the original).
[61] *Id*. at 363.
[62] Cyr v. McGovran, 206 Cal. App. 4th 645, 648, 142 Cal. Rptr. 3d 34, 36 (2012).

agreement between the original option holder and the McGovrans. The plaintiffs sued the grantors' real estate brokers and agents, whom the plaintiffs claimed "had negligently failed to assure that the McGovrans would not grant to their lender an option inconsistent with appellants' options."[63] The court held that the claim was one for negligent performance of professional services, not for injury to an interest in real property.

Another unusual California case involved the relation back doctrine, which the court explained in this way:

> When the holder of an option to purchase real property exercises the option and thereby obtains title to the property, the optionee's title relates back to the date the option was given. As a result, interests in the property that arose between the date of the option and the transfer of title to the optionee are extinguished if the owner of the intervening interest had notice of the option.[64]

The court, however, rejected the holder's argument for priority of its title to the option property over a mechanic's lien filed subsequent to creation of the option but prior to its exercise. The court held that the relation back doctrine did not apply because the holder failed to prove that it had acquired title to the property pursuant to the option. "In order for an optionee to have the benefit of the relation-back rule, the optionee must have been able to compel specific performance of the option."[65]

Yet another California opinion, this one by the California Supreme Court, is especially noteworthy because it gave the court the occasion to address the distinction between a sale contract and an option, as well as to confirm the relevance of consideration in an option agreement. [66] The court held that an agreement designated by the parties as a real estate sales agreement was, in substance, an option contract because the buyer had absolute discretion to terminate the arrangement—not an usual feature in commercial real estate sales contracts by any means. The option was, however, enforceable by the holder against the grantor because it was supported by sufficient consideration. Although an option agreement not supported by consideration is not binding as a contract to sell until the holder exercises the option, thereby converting the arrangement into a purchase and sale agreement, an option is an offer that "may nonetheless be irrevocable for the negotiated period of time if sufficient bargained-for consideration is present."[67] The court found consideration in the holder's partial performance of the holder's agreement to seek approval for a parcel split needed to develop the property even though, at the time the option agreement was entered into, the holder's promise to seek the parcel split was illusory because of the holder's unconditional right to terminate.

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[63] *Id.* at 649, 142 Cal. Rptr. 3d at 37.
[64] Wachovia Bank v. Lifetime Indus., Inc., 145 Cal. App. 4th 1039, 1042, 52 Cal. Rptr. 3d 168, 169-70 (2006).
[65] *Id*. at 1042, 52 Cal. Rptr. 3d at 170. The case stemmed from a complex financing and involved a far more convoluted situation than is described in the text, but the other aspects of the case are, thankfully, beyond the scope of this paper. *See* Murray, *supra* note 2, at 102-07 (discussing the case at length).
[66] Steiner v. Thexton, 48 Cal.4th 411, 226 P.3d 359 (2010).
[67] *Id*. at 420, 226 P.3d at 365.

A Florida case presents an interesting twist on the rule requiring consideration to render an option irrevocable as an offer to sell. At the time the option was granted, it was supported by consideration in the form of the holder's agreement to lease the property and pay rent on an interim basis. But when the parties agreed to cancel the lease before the leasehold term commenced, the consideration for the option was lost and the grantor had the right to withdraw the offer to sell.[68]

Several recent cases consider whether the holder's exercise of an option must strictly comply with the terms of the option agreement. Some adhere to the traditional rule that the holder must exercise the option strictly in the manner and form specified in the option agreement. For example, a New York case held that a purported exercise of an option was ineffective because it specified less than the entire tract designated in the option agreement.[69] Another New York case held that the grantor could rescind the option agreement because the holder failed to pay property taxes as provided for in the option agreement. [70] A Louisiana decision affirmed a trial court's determination that a holder failed to exercise properly because the option agreement required the holder to give notice by registered letter by a specified date but the holder only gave telephonic notice by that date and did not send the registered letter until more than two weeks later.[71] This result may represent an especially harsh application of the rule because the option apparently represented an opportunity for the holder, who was a defaulting mortgagor, to redeem her property following a foreclosure sale.

A Maryland case held that a holder that made multiple attempts to exercise an option failed to satisfy what the court referred to as the *exact matching doctrine* and was therefore not entitled to specific performance.[72] Although the primary defect was the holder's failure to deliver the earnest money deposit at the time specified in the option contract, the court noted that several attempts to exercise the option were also deficient because the terms of the sale contract that the holder tendered did not match the terms required by the option agreement. For example, one of the tendered contracts used a property description that included more property than what the option covered and others incorporated conditions and material terms that deviated from those called for in the option agreement. The court also rejected the holder's argument that the grantor had acted in bad faith by not specifying these defects to the holder. The court held "that a failure to inform the holder of an option right of material deficiencies when that right is attempted to be exercised, generally does not constitute a violation of the good faith requirement."[73]

By contrast, in a New Jersey case, the court applied a less rigid standard on the strict compliance issue, holding that a grantor who realized that the holder erroneously believed an attempted exercise was sufficient and whose conduct created in the holder a false sense of security could be precluded from challenging the exercise by reason of the implied covenant of good faith and fair dealing.[74] The court characterized the landlord's behavior as "artful dodging

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[68] LaRoche v. Nehama, 979 So. 2d 1021, 1022 (Fla. Dist. Ct. App. 2008).
[69] Foye v. Parker, 15 A.D.3d 907, 907, 790 N.Y.S.2d 787, 788 (2005).
[70] Parker v. Booker, 33 A.D.3d 602, 822 N.Y.S.2d 156 (2006).
[71] Casey v. Nat'l Info. Servs., Inc., 906 So. 2d 710, 719 (La. Ct. App. 2005) *writ denied*, 925 So. 2d 1235 (2006).
[72] Elderkin v. Carroll, 403 Md. 343, 941 A.2d 1127 (2008).
[73] *Id*. at 366, 941 A.2d at 1140.
[74] Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Ctr. Assocs., 182 N.J. 210, 864 A.2d 387 (2005).

and studied silence."[75] The court held that the breach of the covenant of good faith and fair dealing was the landlord's "demonstrable course of conduct, a series of evasions and delays, that lulled plaintiff into believing it had exercised the lease option properly. Defendant acted in total disregard of the harm caused to plaintiff, unjustly enriching itself with a windfall increase in rent at plaintiff's expense."[76]

The Washington Court of Appeals also evinced a sympathetic attitude in a situation suggesting inequitable behavior by the grantor.[77] The holder, a private college that subleased two floors of the building in question, missed a deadline for making a $50,000 payment to extend the option. Additionally, when the holder finally tendered payment of the extension fee, it was in the form of a check that only included one of the two signatures called for on the face of the instrument. The grantor returned the check and the college moved out of the building several months later after the grantor-sublandlord issued a sublease termination notice based on the building's deteriorating conditions. Subsequently, the college sued for specific performance of its right to purchase the property on the basis that it had effectively extended the option, and it also sought consequential damages for the grantor's failure to honor the option and damages for wrongful eviction. Although the court recognized that strict compliance is normally required in the exercise of an option, "equitable relief from such strict construction may be warranted in limited circumstances where an inequitable forfeiture would otherwise result."[78] While other aspects of the case (several of which suggest questionable motives on the grantor's part) are beyond the scope of this paper, it is fair to say that the court's willingness to approve the trial court's decision to allow an equitable grace period for exercising the option was influenced not only by the $600,000 that the college had invested in improvements to the leased premises, but also by evidence that the grantor was attempting to avoid the option because an appraisal showed that the property had appreciated as a result of a recent rezoning of the area such that the property was likely worth well over $7,000,000 instead of the $3,000,000 option price.[79]

In a case involving purchase options included in an automobile repair shop lease, the Connecticut Supreme Court adopted a substantial compliance standard and held that the tenant was entitled to specific performance despite the tenant's repeated failures to pay rent on time and to timely perform other obligations under the lease and related agreements.[80] The court explained that even though the *exercise* of an option must strictly comply with the terms of the option agreement that specify the manner and time of exercise, normal principles of contract law allowing for substantial compliance apply to other terms of the option agreement. In this case, although the option contract conditioned the option right on the tenant's performance of its obligations under the lease and related contracts between the parties, the supreme court deferred to trial court findings that the tenant's deficiencies were immaterial. While the trial court's determination in this regard was arguably generous to the holder, the controlling factor may have been that the tenant was current on all of its financial obligations to the grantor as of the date the

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[75] *Id*. at 214, 864 A.2d at 389.
[76] *Id*. at 230-31, 864 A.2d at 399.
[77] Cornish Coll. of the Arts v. 1000 Virginia Ltd. P'ship, 158 Wash. App. 203, 217, 242 P.3d 1, 9 (2010).
[78] *Id*.
[79] *See id*. at 220, 242 P.3d at 10. The sublessor leased the entire property under a master lease with the fee owner, an affiliated entity; a single document served as both the sublease and the option agreement. *See id*. at 210-11, 242 P.3d at 5-6.
[80] Pack 2000, Inc. v. Cushman, 311 Conn. 662, 674, 89 A.3d 869, 878 (2014).

tenant exercised the option. Another Connecticut case, however, upheld a trial court conclusion that where an option agreement provided for the tenant-holder to exercise the option by paying the purchase price, the holder could not be excused from a delay in making the payment on the basis that the lessor-grantor had arguably failed to perform certain of its obligations under the lease.[81]

ROFR cases

A daunting assortment of ROFR cases litter the recent reporters. They definitively show that ROFRs continue to generate disputes involving all of the issues described in part I of this paper, but they do not necessarily add much to our understanding of those issues. In that sense, the recent cases validate the cautious counseling and painstaking negotiating and drafting practices of highly experienced transactional lawyers. And while real estate owners and investors should never structure homespun ROFR agreements without the advice of legal counsel, those who do, or at least those with deep pockets, make excellent business prospects for litigators. Because of the extraordinary number of recent ROFR cases, the majority of which teach old rather than new lessons, I have elected to use this section to discuss one of the most interesting and most recent cases at some length and then, in separate subsections, to offer brief notes on a selection of others that address many of the recurring issues.

The featured ROFR case

I have chosen to highlight a 2015 New York case because it addresses several of the most common issues that arise in ROFR disputes, plus it explores a rare, bonus topic. In *Peters v. Smolian*, the court characterized the plaintiffs-title owners as having orchestrated "a celebrity-studded publicity campaign to induce the defendants into waiving" their rights of first refusal.[82] In dealing with motions for summary judgment, the court held that the plaintiffs were bound by the ROFR and therefore were not free to convey the property, along with other land, to the Town of East Hampton. The plaintiffs' title stemmed from deeds from Richard Smolian that were made subject to a ROFR in favor of Richard and other members of the Smolian family.

The plaintiffs entered into the sale contract with the town without first offering the holders the right to purchase the property for the $3,600,000 price the town offered. The plaintiffs paid Richard $50,000 to sign a waiver of his ROFR, but the other family members refused to join in that waiver. A rider to the sale contract with the town added what the court characterized as a self-serving covenant that the property would remain as open space. "Thereafter, in November and December of 2014, a newspaper campaign was commenced to urge the Smolian Family to relinquish their right of first refusal."[83]

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[81] Howard-Arnold, Inc. v. T.N.T. Realty, Inc., 315 Conn. 596, 109 A.3d 473 (2015).
[82] Peters v. Smolian, 49 Misc. 3d 408, 411, 12 N.Y.S.3d 824, 829 (N.Y. Sup. Ct. 2015).
[83] *Id*. at 413, 12 N.Y.S.3d at 831. Several news articles covered aspects of the larger story. *See, e.g.,* Matt A. V. Chaban, *In the Hamptons, a Fight Over Land Is Also One Over Water, N.Y. TIMES (Nov. 24, 2014),* *http://www.nytimes.com/2014/11/25/nyregion/in-the-hamptons-a-fight-over-land-is-also-one-over-water.html?_r=0.*

The opinion is worth reading in the first instance because it restates and carefully analyzes many of the fundamental principles governing ROFRs as followed in most jurisdictions, as well as because it addresses other common issues on which conflicting authority exists. The court held that the right granted to members of the Smolian family via the deed from Richard Smolian was a personal, contract right of those four individuals and not an interest in the real estate that ran with the land, or at least not a legal interest, as contrasted to an equitable one. (Delightfully, the court even mentioned the classic *touch and concern* standard for determining whether a covenant runs with the land—but, alas, I must not digress that far into property law theory.) Given this analysis, the ROFR did not violate the Rule Against Perpetuities, nor was it an unreasonable restraint on alienation.

The plaintiffs also challenged the ROFR under the Statute of Frauds because the hold-out holders were not parties to the deeds granting the ROFR. This exceptionally weak argument failed given that the Statute only requires a writing signed by the party to be bound, not one signed by those seeking to enforce. One of the plaintiffs was not a party to the original deeds, but the ROFR was clearly of record and known to that plaintiff, who took title under a deed that incorporated the terms of the ROFR.

As an alternative to their arguments for the ROFR's invalidity, the plaintiffs sought a declaratory judgment that if the defendants were entitled to exercise the ROFR, they would need to match all of the terms of the agreement with the town, including the open space condition. Objectively, this legal proposition might have carried considerable weight. But to guess how the court felt about this argument, one need only harken back to the court's gratuitous comment that the open space covenant was introduced into the contract with the town via a "rather self-serving Rider," as a kind of contractual afterthought four months following execution of the original contract.[84] In any event, the court dismissed the issue as not ripe for determination because the plaintiffs had not yet given the holdouts the opportunity to exercise the ROFR.

Despite concluding that the matching issue was not ripe, the court gave significant attention to the possibility that the plaintiffs' open space maneuver could have violated their duty of good faith and fair dealing. Adding dicta to dicta, the court also speculated that because the ROFR rendered the plaintiffs' title unmarketable, the Town might exercise a right under its contract not to close, in which case the ROFR would again revert to the status of a dormant right. In a final point relating to the matching issue, the court offered these comments, which were clearly unnecessary to the result, arguably of questionable legal merit, but no doubt intended as a signal to Alexander Peters, the primary plaintiff:

> just as it is settled that the grantor of a right of first refusal cannot defeat the right merely by subdividing a parcel into smaller pieces and conveying only a partial interest . . ., or by offering the property for sale only as part of a larger parcel . . . , it would appear that Peters cannot defeat the right of first refusal by eliminating one of the more important

[84] *Id*.

sticks from the "bundle of sticks" that constitute the rights of ownership of real property, that is, the right to utilize the property in keeping with the applicable zoning ordinances.[85]

The bonus issue in this case, which earns it the place of honor in the theoretical realm, is the court's ruling on the *stranger to the deed rule*. The court explained that under long-standing New York precedent "a deed with a reservation or exception by the grantor in favor of a third party, a so-called 'stranger to the deed,' does not create a valid interest in favor of that third party."[86] While the court examined several apparent exceptions to the stranger to the deed rule, and even entertained the possibility that the rule deserves no place in contemporary law, the court's rationale for rejecting the plaintiffs' argument was that a ROFR included in a deed is neither a reservation from the grant nor an exception to the grant. Of all the theoretical issues that courts face in ROFR cases, the stranger to the deed rule seems to be one of the least common and, thus, from my peculiarly theoretical approach in this paper, among the most charming of all.

As already mentioned, many of the other recent ROFR cases I reviewed address fairly routine issues. That is not to say, however, that they hold no interest for our purposes. The remainder of this segment of the paper briefly notes my favorites among this mass of cases. I am covering these cases in chronological order under major topical subheadings, except that I am grouping together cases within a subheading that deal with closely related aspects of the topic the subheading covers. Some cases are noted under more than one topical subheading.

ROFR basics

Gilmore v. Jordan, 132 A.D.3d 1379, 17 N.Y.S.3d 545 (2015): the ROFR contained in a contract merged into the deed delivered pursuant to the contract and was extinguished upon the grantor's death because the deed, in contrast to the contract, did not purport to bind the grantor's heirs and assigns.

Anderson v. Parker, 351 S.W.3d 827, 831-32 (Mo. Ct. App. 2011): "A preemptive right that does not specifically provide that it is binding on the heirs and assigns of the parties and does not indicate an intent that it survive beyond the lifetime of the parties is personal to the parties and expires on death."

Bayer v. Showmotion, Inc., 292 Conn. 381, 973 A.2d 1229 (2009): the tenant-holder properly exercised its ROFR under a lease, thus creating a binding contract of purchase and sale, even though the parties subsequently failed to agree on certain nonessential terms of the purchase and sale agreement. Under Connecticut law, the essential terms for a purchase and sale agreement "include the parties, a description of the subject of the sale, and the terms of payment, including a basis for determining the total purchase price and the amount, if any, of the purchase money mortgage." 292 Conn. at 412-13, 973 A.2d at 1249. Moreover, the holder was not in breach of the lease for failing to pay rent after exercising the ROFR "because the lease had been terminated upon exercise of the defendant's preemptive option." 292 Conn. at 415-16, 973 A.2d

[85] *Id*. at 428-29, 12 N.Y.S.3d at 842.
[86] *Id*. at 416, 12 N.Y.S.3d at 833.

at 1250-51. Treating the proper exercise of the ROFR the same as the exercise of an option, the court held that the relationship between the parties became that of vendor and purchaser, the lease was extinguished, and the doctrine of equitable conversion gave equitable title to the holder.

Jewish Ctr. for Aged v. BSPM Trustees, Inc., 295 S.W.3d 513 (Mo. Ct. App. 2009): a case with a delightful twist. A ground lease between the fee owner, as landlord, and its affiliate, as tenant, contemplated that the tenant would enter into a leasehold deed of trust under a HUD loan program. The lease provided that the landlord would have a "first right to acquire" the leasehold interest at its fair market value if the tenant defaulted under the leasehold deed of trust and the beneficiary determined to pursue any action that could affect possession. The parties and the court characterized the right as a ROFR, and I include the case in this section on that basis even though the lease granted a purchase option conditioned on default under the deed of trust and the prospect of a foreclosure sale rather than a right trigger by a proposed voluntary sale of the property as in a typical ROFR. An addendum to the ground lease added provisions required by HUD, but the addendum left the ROFR in place. A recorded memorandum of lease inaccurately described the ROFR, but the error was subsequently corrected of record, and it was uncontested that the assignee of the deed of trust knew of the ROFR before acquiring the deed of trust. The court held that the ROFR, which included a requirement for the ground lessor to receive notice of the triggering event—a notice that presumably could be given only by or at the direction of the holder of the deed of trust—was a covenant running with the land and was superior to the lien of the deed of trust. The net result, at a minimum, was to buy time for the ground lessor because the foreclosure proceedings could not yet commence as proper notice had not been given under the terms of the ROFR.

Starr v. Wilson, 11 So. 3d 846 (Ala. Civ. App. 2008): where an agreement providing for the sale of one parcel also granted the buyer a ROFR on a second parcel, no separate consideration beyond the purchase price for the first parcel was required to support the ROFR, and delivery of the deed to the first parcel did not extinguish the ROFR under the merger by deed doctrine.

Rappaport v. Estate of Banfield ex rel. Hoguet, 924 A.2d 72 (Vt. 2007): the Statute of Frauds prevented the holder from claiming that the ROFR extended to more property than the written agreement covered.

Triggers

Pew v. Sayler, 2015 ME 120, 123 A.3d 522: ROFR in agreement between cotenants implicitly waived right of partition.

Tuminno v. Waite, 110 A.D.3d 1456, 1457, 972 N.Y.S.2d 775, 777-78 (2013) (citations omitted): "We agree with Waite on her appeal that the court erred in determining that the contractual right was triggered upon plaintiff's commencement of the instant action, for partition and sale. It must first be determined in a partition action whether the property may be partitioned, i.e., divided among the owners in some fashion, without great prejudice to them, and 'partition sale' is a secondary consideration only in the event that partition greatly prejudices the owners. Thus, commencement of the partition action did not trigger the right of first refusal inasmuch as a partition, as opposed to a partition sale, would not result in a transfer of the property to a third party. Furthermore, no offer of purchase from a third party triggered either the right of first refusal or the contractual obligation of plaintiff or Waite pursuant to the settlement agreement or recorded document."

LEG Investments v. Boxler, 183 Cal. App. 4th 484, 107 Cal. Rptr. 3d 519 (2010): ROFR contained in a tenancy in common agreement did not implicitly waive right to partition; once co-tenant gave the other co-tenant notice of proposed sale of its interest to third party and the other co-tenant refused to exercise the ROFR, partition by sale was available. An interesting side note in this case is that the third-party offer included a condition for the proposed buyer to approve the non-selling cotenant and, after the non-selling cotenant refused to exercise the ROFR, the proposed buyer determined that the non-selling cotenant was not acceptable and declined to close the purchase on that basis. A cynic might want to make much of the evidence indicating that the non-selling co-tenant was an extremely difficult character. Might the proposed sale, conditioned as it was on the buyer's approval of an apparently unsavory co-tenant, have been a bit too convenient as a predicate for seeking partition by sale of the property?

DePetrillo v. Belo Holdings, Inc., 45 A.3d 485, 493 (R.I. 2012) (citations omitted): the court confirmed the holdings of earlier cases in which a grantor wished to sell a larger tract that included the parcel subject to the ROFR, and approved an alternative course of action for the holder. The opinion states that: "'a seller may not defeat a right of first refusal by selling the property subject to the right as part of a larger tract' and that, 'while the holder of such a right may not force a separate sale of the land, s/he may enjoin the proposed sale of a larger tract of land that includes the parcel subject to the right of first refusal.' Thus, as holder of the right of first refusal, Citadel was in the following quandary: it was unable to compel the separate sale of the tower and transmission site, yet it had the power to block the sale of the thirty-acre parcel. Opting for the arguably more efficient and practical approach, in exercising its right of first refusal, Citadel instead chose to match DePetrillo's [plaintiff-third party buyer's] offer to purchase the thirty-acre parcel. This approach enabled Belo [the grantor] to achieve its objective of selling the entire parcel, while still honoring Citadel's right of first refusal. Belo was completely within its authority to execute such a sale, as the plaintiff's rights to the property had terminated upon Citadel's failure to waive its right of first refusal." The court's pronouncement that the holder would have the right to enjoin the sale of the larger parcel is arguably the majority view of courts across the country, but this case goes the further step of recognizing an alternative for the holder, with the approval of the grantor, in effect to preempt the third-party offer for the entire tract.[87] The result seems logical because if the grantor is unable to accept the third-party offer that includes the property subject to a ROFR that the holder will not waive, there is no

[87] *See* Murray, *supra* note 2, at 80-86.

reason to prevent the holder and the grantor from agreeing to a sale of the larger tract on the same terms as the third-party deal.

Advanced Recycling Sys., LLC v. Se. Prop. Ltd. P'ship, 787 N.W.2d 778 (S.D. 2010): landlord's sale of a development that included the leased property covered by the tenant's ROFR plus other land did not trigger tenant's right. This was an issue of first impression for the South Dakota Supreme Court, which stated it was adopting the majority position on the issue. The question whether the tenant's ROFR continued in effect after the sale was not before the court because the tenant had already negotiated a new lease with the third-party buyer. *See id*. at 782.

Roeland v. Trucano, 214 P.3d 343, 351 (Alaska 2009): transfer to LLC that resulted in same parties retaining control of the property did not trigger ROFR because the transfer was a "mere matter of form."

Rucker Properties, L.L.C. v. Friday, 41 Kan. App. 2d 664, 665, 204 P.3d 671, 673 (2009): "the transfer in question was a quitclaim deed executed as a gift by family members in favor of specific members of that family. As no sale existed, it did not trigger the right of first refusal."

Schroeder v. Duenke, 265 S.W.3d 843 (Mo. Ct. App. 2008): sale of the property to grantors' son at a price that was arguably far below its fair market value was not akin to a gift and therefore it could trigger the ROFR, but whether or not the sale resulted from a bona fide offer was a question of fact to be determined at trial. Under Missouri law, a bona fide offer is one that is based on the fair market value of the property, but need not be for the full fair market value.

Huntington Nat. Bank v. Cornelius, 80 A.D.3d 245, 914 N.Y.S.2d 327 (2010): a foreclosure sale, not being the voluntary act of the grantor, did not trigger ROFR. The ROFR was granted and made of record prior to the mortgage, but the court expressly pointed out in footnote 2 of the opinion that the appeal did not require the court to address whether or not the ROFR would survive the pending foreclosure sale should the purchaser at the sale subsequently decide to sell the property during the remainder of the original 20-year term of the ROFR.

Wells Fargo Bank, N.A. v. Michael, 2013-Ohio-2545, ¶ 46, 993 N.E.2d 786, 794 appeal not allowed, 2013-Ohio-4861, ¶ 46, 136 Ohio St. 3d 1559, 996 N.E.2d 986 (emphasis in original): "Although we hold that, in this case, foreclosure was not a triggering event for this *right of first refusal,* our decision does not stand for the proposition that foreclosure can never be a triggering event for a *right of first refusal.* The covenant could be drafted in a manner that renders foreclosure a triggering event for the *right of first refusal."* The court distinguished a previous Ohio case, National City Bank v. Welch, 2010-Ohio-2981, ¶ 21, 188 Ohio App. 3d 641, 648, 936 N.E.2d 539, 545, which held that (1) the holder of a preferential right could purchase property that was subject to a mortgage that was in foreclosure at the time the holder sought to enforce the right because the mortgagor's death triggered the right (which the court characterized as a ROFR, although it might more accurately have characterized the right as an option), but (2) the mortgage lien would survive if the holder exercised the right. (The net result of the *Welch* case apparently was that the holder could acquire the property from the decedent's estate for the fixed price established by the terms of the agreement granting the preferential right, but would take title subject to a mortgage securing what may have been a much larger sum, although the amount of the outstanding balance on the mortgage loan was not stated in the opinion.)

Burns v. Clutter, 15 So. 3d 251 (La. Ct. App. 2009), writ denied sub nom. Succession of Burns v. Clutter, 28 So. 3d 1025 (La. 2010): because a bond for deed (installment sale contract) triggered the ROFR, the limitations period on the holder's cause of action for breach of contract began to run at that time.

Bergman v. Commerce Trust Co., N.A., 129 P.3d 624 (Kan. Ct. App. 2006): a transfer pursuant to a settlement agreement reached in connection with a will contest did not trigger the ROFR.[88]

Matching terms

Castle Properties, Inc. v. Wasilla Lake Church of the Nazarene, 347 P.3d 990 (Alaska 2015): where a city's third-party offer was to swap land that the grantor had a special interest in acquiring, the holder had the right under the ROFR to make a commercially equivalent offer. The evidence was sufficient, however, to support a finding that the grantor's rejection of the cash offer, as not being comparable to the city's offer, was commercially reasonable. The court also held that the holder received adequate notice of the third-party offer by obtaining a copy of the city ordinance authorizing the proposed transaction even though the grantor failed to a provide notice and refused to furnish a copy of the proposed agreement with the city.

Fienberg v. Hassan, 928 N.E.2d 356 (Mass. App. Ct. 2010): a holder who failed to match the third-party offer's closing date did not validly exercise the ROFR.

Roeland v. Trucano, 214 P.3d 343, 349-50 (Alaska 2009): The third-party offer was to acquire a partial interest in the property in exchange for a partial interest in the business the third-party proposed to operate on the property. The court held that "[w]here a commercial seller has received a unique offer that a right-holder could not exactly duplicate, we agree with courts characterizing the submission of the offer to the right-holder as an invitation to the right-holder to submit a commercially equivalent offer. The right-holder may propose comparable terms to the original offer which are possible for him to meet and which would meet the seller's commercial interests. The seller then has a duty to use commercially reasonable standards to evaluate the two offers."

St. George's Dragons, L.P. v. Newport Real Estate Grp., L.L.C., 971 A.2d 1087 (N.J. Super. Ct App. Div. 2009): the grantor claimed that the holder had to offer not simply the same purchase price as the third-party offer, but the same net yield to the grantor. Rejecting this

[88] The question whether the ROFR continued in effect following the transfer of the property pursuant to the settlement agreement was not before the court. Presumably, that issue would turn on whether the original parties to the declaration that established the ROFR intended a personal obligation of the grantor or a covenant running with the land. Under the Restatement, unless the language the parties use expresses a contrary intent, in most cases the burden of a ROFR will run with the land. *See* RESTATEMENT, *supra* note 7, § 5.2.

argument, the court held “neither the refusal clause nor the third-party contract guaranteed the owner a net recovery on the sale or required the buyer to pay brokers' commissions.” *Id*. at 1090-91. In fact, there was evidence that during the ROFR negotiations, the holder insisted on striking a proposed term for the holder to pay the broker’s commission if the holder purchased the property pursuant to the ROFR.

Jones v. Stahr, 746 N.W.2d 394 (Neb. Ct. App. 2008): the addition of a clause reserving a right to assign was not a fatal deviation from the terms of the third-party offer.

Del. River Pres. Co., Inc. v. Miskin, 923 A.2d 1177, 1182 (Pa. Super. Ct. 2007): the holder failed to exercise the ROFR effectively by not agreeing to a restriction included in the third-party offer to prohibit development of the property. “The changes Appellant made to the terms of the initial third-party offer, whether material or non-material, did not constitute an unequivocal acceptance of the third-party offer.” This statement notwithstanding, it seems that the restrictive covenant was material under the circumstances, because after the holder purported to exercise the right without agreeing to the use restriction, the third-party offered to increase the purchase price it was willing to pay by more than one-third in exchange for omitting the restriction.

Christian v. Edelin, 843 N.E.2d 1112 (Mass. App. Ct. 2006): the holder’s offer that included a financing condition was not substantially the same as the third-party’s cash offer.

The RAP and illegal restraints on alienation

MS Real Estate Holdings, LLC v. Donald P. Fox Family Trust, 362 Wis. 2d 258, 266, 864 N.W.2d 83, 87 (Wis. 2015): rejects the argument that a ROFR should be terminable by the grantor after a reasonable period of time simply because the ROFR agreement fails to specify an expiration date for the right. I find the case especially noteworthy because the logic is reminiscent of the Restatement’s theory on illegal restraints on alienation. “We hold that a right of first refusal contract is definite as to duration when it specifies an event that triggers the right and requires the right holder to either exercise or waive the right within a specified period of time thereafter, even if the triggering event is not certain to occur. Therefore, the right of first refusal contract at issue here is not terminable at will after a reasonable period of time.”

Pew v. Sayler, 2015 ME 120, 123 A.3d 522: the ROFR in a deed violated the RAP and was void, but the same ROFR in a separate contract was valid as against the parties to the contract.

Jarvis v. Peltier, 400 S.W.3d 644, 652 (Tex. App. 2013): “In Texas, a preferential right to purchase or a right of first refusal does not violate the rule against perpetuities.”

Hensley-O'Neal v. Metro. Nat. Bank, 297 S.W.3d 610 (Mo. Ct. App. 2009): where no duration was specified for exercise and the ROFR agreement expressly provided that it was binding on heirs and assigns, the ROFR was unenforceable because it violated the RAP.

Bortolotti v. Hayden, 449 Mass. 193, 866 N.E.2d 882 (2007): The RAP did not apply to the ROFR, and the ROFR did not constitute an unreasonable restraint on alienation. In this case, although the Massachusetts version of the Uniform Statutory Rule Against Perpetuities also would have resolved the issue in favor of the holder, the court applied the common law RAP because the ROFR predated the statute. A similar case is Old Port Cove Holdings, Inc. v. Old Port Cove Condo. Ass'n One, Inc., 986 So.2d 1279 (Fla. 2008).

CS-Lakeview at Gwinnett, Inc. v. Simon Prop. Grp., 283 Ga. App. 686, 689, 642 S.E.2d 393, 397 (2007) aff'd sub nom. CS-Lakeview at Gwinnett, Inc. v. Simon Prop. Grp., Inc., 283 Ga. 426, 659 S.E.2d 359 (2008): the ROFR was unenforceable under the Delaware RAP, which controlled because the parties chose Delaware law to govern their settlement agreement that included the ROFR. The Georgia Supreme Court affirmed, with the only issue before it being whether there was a basis to reform the agreement for mutual mistake of law in not selecting Georgia law, under which the ROFR presumably would have been valid. In this regard, the Georgia Supreme Court held: "a choice of Georgia law may have had its own undesirable implications for the multiple entities and properties involved in the settlement agreement. It is not possible to conclude that the parties clearly and unequivocally intended the choice-of-law provision to fall whenever it would invalidate any provision of the contract. To assume that the parties intended for the right of first refusal to be effective instead of their choice of law is not any more justifiable than the converse assumption." CS-Lakeview at Gwinnett, Inc. v. Simon Prop. Grp., Inc., 283 Ga. 426, 429, 659 S.E.2d 359, 362 (2008).

ROFRs for fun and profit, or "Those jokers did ***what****?"*

Something there is about a ROFR that inspires clever maneuvers, suspicious behavior, trickery, and downright bad conduct. Peters v. Smolian, discussed at length at the beginning of this segment on ROFR cases, also deserves a place under this subheading. At least as far as the court was concerned in that case, the landowners attempted to evade the holders' rights through strategic collusion with the third-party buyer, an unseemly publicity campaign, and borderline bad faith. (Readers of the *New York Times* article cited at footnote 83 *supra*, however, might suspect another side to the story that paints the warring parties rather differently than the court seemed to do). Those looking for similar entertainment may wish to read some of the opinions in the cases that follow under this subheading.

Jarvis v. Peltier, 400 S.W.3d 644 (Tex. App. 2013): the grantor sold the property to a third party without providing any notice to the holder; when the holder discovered the sale some two years later, the grantor and the buyer refused to provide the details of the sale, which the holder only learned via discovery after bringing the lawsuit. Advancing a strict compliance argument that must have been difficult to pursue in court with straight faces, the grantor and the buyer unsuccessfully asserted that the holder had failed to comply with the ROFR by not exercising the right within 30 days of learning of the sale.

Waste Connections of Kansas, Inc. v. Ritchie Corp., 296 Kan. 943, 298 P.3d 250 (2013): the third-party contract provided for a package deal that included the ROFR property and other property at a total purchase price of $4,950,000, with $2,000,000 allocated to the ROFR property if the package deal closed, but if the holder exercised the ROFR, the third party would pay only $3,500,000 for the balance of the package. In other words, the net price the seller would receive if the holder exercised the ROFR would be $5,500,000, but if the third-party buyer purchased all of the property, the net would be only $4,950,000. The evidence showed that the third-party buyer did not care how the contract purchase price was allocated as long as it could acquire at least the portion of the land not covered by the ROFR and pay $3,500,000 for that portion. The holder tendered the full $2,000,000 under a reservation of rights to seek a judicial determination of the true price owed pursuant to the ROFR. The trial court and the Kansas Court of Appeals had conflicting views on which party was entitled to summary judgment, but the Kansas Supreme Court sent the case back for trial. On one aspect of the case, the court commented: "we emphasize that the fact question of the existence of good or bad faith is peculiarly inappropriate for summary judgment." 296 Kan. at 974, 298 P.3d at 271.

Lenco Investments Ltd. v. 1440825 Ontario Inc., 2014 ONCA 903, 2014 CarswellOnt 17545: in this Canadian case involving a ROFR in a commercial lease, the ROFR provision ended with the statement that the right would terminate if either the landlord or the tenant terminated the lease as permitted under other provisions of the lease, including a provision permitting the landlord to terminate the lease in connection with a sale of the premises. Predictably, when the landlord received a third-party offer that it wished to accept, the landlord entered into that contract and promptly gave a lease termination notice to the tenant. The Ontario Court of Appeal sided with the tenant, holding that the ROFR and the lease termination provisions should be read together such that the landlord could only terminate the lease after receiving a third-party purchase offer if the tenant declined to exercise the ROFR.

Richmond v. EBI, Inc., 53 So. 3d 859, 865 (Miss. Ct. App. 2011): "adamant refusal to meet the offered purchase price and protracted attempts to secure a significantly lower purchase price amount to Brian's failure to exercise his rights according to the terms of the right of first refusal."

Rappaport v. Estate of Banfield ex rel. Hoguet, 924 A.2d 72 (Vt. 2007): the third-party offeror may have successfully worked around a ROFR through a bit of strategic pricing in a package deal by allocating what seemed to be an unrealistically high portion of the total purchase price to the 25.1 acre parcel that the ROFR covered. An especially interesting feature of this case is that the holder exercised the ROFR and purchased the 25.1 acre parcel at what he claimed was the inflated price, and then sued for breach of contract and intentional interference with his contractual rights. In affirming a judgment against the holder, the court was satisfied that the evidence supported the conclusion that the third-party offeror "had valid reasons for making a high bid on the 25.1-acre parcel to prevent plaintiff from acquiring it, including preserving the spectacular views from the house on the larger parcel, keeping the property intact, and controlling the land itself. If plaintiff acquired the lot, the agricultural easement held by plaintiff would be extinguished and the lot could be developed." *Id*. at 74.

Bergman v. Commerce Trust Co., N.A., 129 P.3d 624 (Kan. Ct. App. 2006): the court avoided ruling on whether either the holder's offer to purchase or a similar offer made by the holder's friend, who apparently made the offer as a favor to the holder, was a bona fide offer because there was no evidence that the special administrator of the grantor's estate was willing to sell for the price offered.

Jeremy's Ale House Also, Inc. v. Joselyn Luchnick Irrevocable Trust, 22 A.D.3d 6, 8, 798 N.Y.S.2d 416, 416 (2005): This case deserves the final slot in this segment, as it involved a last right of refusal rather than a first right. It shows either shrewd or brazen behavior, but I leave it to you to decide whether the grantor or the holder was the more shameless actor. "The right of refusal at issue, as it plainly states, is a 'last right of refusal to beat the terms and price by 3% of any bona fide offer.' Thus, Jeremy's is not entitled to specific performance of the $2.7 million offer because it was not the last offer. Contrary to its arguments, Jeremy's was not entitled to select the offer it considered the most advantageous. Its right was limited to the last offer. That being the case, the Trust could, without breaching its implied covenant of good faith and fair dealing with respect to Jeremy's right of refusal, by communicating a series of escalating bona fide third-party offers, use Jeremy's as a stalking horse to prompt it 'to beat the terms and price' of those offers so as to induce a higher third-party offer."

ROFO cases

One of the most recent ROFO cases illustrates how the flexible nature of the ROFO device can lead to unintended consequences. The predecessor to SKI, Ltd. sold 33 acres to Mountainside Properties, Inc. for current development purposes and granted a ROFO to Mountainside on 62 additional acres that could not then be developed because of inadequate sewer treatment capacity.[89] At the time, the grantor owned the sewer treatment facilities, located on other land, that would presumably be able to provide the necessary capacity at a later date. The ROFO provided that if the grantor decided to sell the 62 acres, it would first offer that property to Mountainside at its market value (as determined by the grantor), along with sewer disposal rights sufficient for a designated number of dwelling units.[90] By virtue of various subsequent transactions, title to the 62 acres eventually came to be held by SKI, while an unrelated development group (the "neighboring investor") acquired the sewer treatment facilities and other land in the area. Mountainside became an active opponent of the neighboring investor's development plans. When SKI decided to sell the 62 acres, it made an offer to Mountainside to sell the property for $390,000, along with sewer disposal rights sufficient for eight dwelling units. The offer, however, was contingent on Mountainside agreeing not to oppose any plans for development of the neighboring investor's land. SKI claimed that because it no longer owned the sewer treatment facilities, the only way that it could offer sewer disposal rights along with the 62 acres was to comply with the neighboring investor's no-contest condition.

[89] SKI, Ltd. v. Mountainside Properties, Inc., 2015 VT 33, 114 A.3d 1169 (2015).
[90] A preferential right on these terms possibly blurs the line between a ROFO and a ROFR, but it seems fair enough to call this one a ROFO because the grantor must approach the holder *before* dealing with a third party.

The primary issue presented to the Vermont Supreme Court was whether SKI's offer complied with the terms of the ROFO. The court held that it did not. "The record supports the trial court's finding that the ROFO did not anticipate that Mountainside would have to give up its rights to oppose development within the Killington Ski Area in order to exercise its rights."[91] As a result, the ROFO remained in force, and SKI was not free to sell the property to a prospective purchaser who was willing to accept the terms of the offer.

SKI's alternative argument was that the ROFO constituted an illegal restraint on alienation because, as the circumstances evolved, Mountainside might be able to prevent the sale of the property indefinitely given that SKI had no control over the neighboring investor's demand for the no-contest agreement as a condition to providing the sewage disposal rights. Apparently satisfied with the prospect that commercial realities might ultimately resolve the dilemma, the court reasoned that "while the condition may have stalled the transfer of the parcel, it does not definitively preclude alienation of the sixty-two-acre parcel."[92]

A Hawaii ROFO case addressed a question that often comes up with respect to ROFRs. "At issue in this appeal is whether the sale of a large undivided parcel of real property triggered a lessee's right of first refusal to purchase a small part of that property. Based on the specific circumstances of this case, we hold that it did."[93] The parcel subject to the ROFO was a half-acre that included a house, and the larger parcel covered 1040 acres. Throughout the opinion, the court referred to the arrangement as a ROFR, but the agreement in fact was that if the grantor wished to sell, the grantor would first offer the property to the holder on terms specified by the grantor. The court rejected what it characterized as the majority rule (relying extensively on ROFR cases), under which the sale of the larger parcel would not trigger the holder's rights. The court conclude that this rule would, in effect, relieve the grantor "of its duty of good faith and fair dealing in performing the contract."[94] The justification for the court's holding is arguably much stronger under a ROFO (at least one on terms such as those involved in the case) than under a ROFR because such a ROFO leaves it to the grantor to specify the terms of the triggering offer, thereby giving the grantor complete discretion to characterize its intent as either a desire to sell the property subject to the ROFO or a desire to sell only a larger tract that includes that property. If a proposal to sell a larger tract does not trigger a ROFO, it would be relatively easy for a grantor in many situations to sidestep the holder's rights.

A secondary issue in this case was whether the ROFO was unenforceable because a sale of the small parcel out of the larger undivided tract would violate the applicable subdivision regulations. The court rejected this argument, saying that the grantor's offer could have covered this as a contingency. "The meaning of the phrase 'terms and conditions provided by the Licensor' could have included the purchase price, possibly taking into account the cost of seeking a subdivision of the half-acre parcel (including attempts to grandfather in the subdivision

[91] SKI, Ltd., 2015 VT at 25, 114 A.3d at 1175.
[92] *Id*. at ¶ 39, 114 A.3d at 1180.
[93] Kutkowski v. Princeville Prince Golf Course, LLC, 129 Haw. 350, 350-51, 300 P.3d 1009, 1009-10 (2013).
[94] *Id*. at 359, 300 P.3d at 1018.

of the smaller parcel or attempts to seek a variance from the subdivision ordinance), or attempts to create a condominium property regime, or other attempts" that could effectuate the ROFO.[95]

The final entry for this subsection is a 2007 case out of Georgia involving a ROFO that seemingly provided that if the grantor wished to sell the property the grantor would first be required to offer the property to the holder for its appraised value.[96] Once a ROFO on these terms is triggered, the holder effectively has an option to purchase the property at a set price. The holder, obviously eager to purchase, argued that the grantor was obligated to give notice of a desire to sell immediately upon forming a subjective desire to market the property. The court was unimpressed by this ambitious (outlandish?) theory. The court explained that "provided that Plaintiff has neither offered the property for sale nor listed it with a broker, her failure to send Seller's Notice does not constitute a breach of the Sale Agreement irrespective of whether she has formed some subjective desire to sell."[97]

Conclusion

I leave it to you to decide whether contract law theory, property law theory, and economic analysis offer much help to lawyers dealing with options, ROFRs, and ROFOs in practice. Based on the cases and authorities discussed in this paper, consider these closing thoughts:

- With respect to these devices, there is not much new under the sun—the same issues keep coming up, which certainly means that lawyers should continue to draft options, ROFRs, and ROFOs to cover the theoretical problems as well as practical contingencies.
- The principles that the Restatement advocates may be worth keeping in mind, especially when the issue is more theoretical than practical.
- The duty of good faith and fair dealing potentially has especially sharp teeth in some disputes stemming from options, ROFRs, and ROFOs.
- You might inquire whether a first right to negotiate or even a commitment to auction may ever be a realistic alternative to a ROFR or a ROFO.
- ROFRs and ROFOs involve far more complications and challenges, both in theory and in practice, than options.
- ROFRs may generally be more advantageous to holders than ROFOs while, at least in some situations, ROFOs may be more advantageous to grantors.
- A client considering a ROFR or a ROFO should weigh the current benefits of making the deal against the practical risks and problems that these preferential rights inherently entail.

Oh yes, as for those of you interested in that law professor's musings about mortgage theory at the beginning of this paper, here is my explanation. The mortgage being foreclosed was

[95] *Id*.
[96] Stephens v. Trust for Pub. Land, 479 F. Supp. 2d 1341, 1347 (N.D. Ga. 2007).
[97] *Id*. at 1349.

most likely granted many years before the foreclosure sale. In a jurisdiction that strictly adheres to the title theory of mortgages, one could argue that the event triggering the ROFR occurred when the mortgagor granted the mortgage, because in a title theory jurisdiction, in theory, the mortgagor conveyed title to the mortgagee at that time (albeit, as you no doubt recall, a defeasible title subject to a condition subsequent). On that basis, the law professor wants to argue that the statute of limitations on any action to enforce the ROFR may have run long ago. As far as I know, there is absolutely no practical prospect for this entirely academic proposition to succeed, but in theory, it's an argument. It might earn a clever law student half a point on a 100-point exam question.