

Preemptive Rights and Wrongs: First-Refusal and First-Offer Rights

Sitting in your office, basking in the sense of accomplishment, perhaps hugging a beer or a glass of pinot noir, you have finished the All Brands USA lease for 50,000 square feet at Mallchester Mall after six months of exhausting negotiations. With a few clean up changes, you can complete the lease in a few minutes. Then, the phone rings and it is your client, Boris Bellicose, the owner of Mallchester Mall.

"Lynn," he says, "I just got off the phone with All Brands USA, and they are ready to sign. However, their board says they need a first-refusal right if we intend to sell. Just add a sentence to that effect to the lease and shoot it over to me for signature."

"Boris," you reply, the afterglow of the alcohol being replaced with whispers from your malpractice carrier, "how can we give them a refusal right on their store when it is part of the Mallchester Mall and not separately described?"

"Lynn," is the response, "I don't give a [expletive deleted], I need the lease to refinance the mall. If you cannot give them their building, give them something else, the whole center is OK, we need to give them something."

Bearing in mind that your client will be unable to recall this conversation five seconds after he hangs up, you will need to consider the below matters.

Rights of First Refusal

A right of first refusal, frequently referred to as an ROFR, is the right

of its holder to match the purchase terms of a third-party purchase offer. This right is "triggered" or activated when the owner of the property burdened by the right obtains a purchase offer from a third party, either in the form of a purchase contract or a term sheet or letter of intent, that the owner would like to accept.¹

• *The Property* — It is important to determine the property encumbered by the refusal right. The above example reflects that it may be impractical to afford a tenant a refusal right over its space. If the leased space is part of a larger parcel, it is unlikely that the tenant will have the ability to acquire the larger parcel. Perhaps the rights holder isn't interested in the entire shopping center but only in its parcel. If you are able to obtain a separate legal description, but then your client receives an offer to purchase the shopping center, and not merely the separate parcel, what is the result? Would your client lose the unencumbered right to sell a larger parcel? Similarly, should you grant a tenant a refusal right on the shopping center, would that create a problem upon a sale of Mallchester Mall in a portfolio transaction where a fund is purchasing Mallchester Mall and six other shopping centers from your client?²

A preemptive right applicable to real estate generally only applies to the sale of real property. Accordingly, a sale of ownership interests in the property owner may be a method of avoiding the ROFR.³

• *The Trigger* — The trigger for activating the first refusal right may

be a term sheet, a letter of intent or an executed purchase contract. Is it likely that a third-party purchaser will negotiate a purchase contract and undertake the expenses of due diligence and legal fees with the threat of losing the property to the rights holder overlaying the transaction? A ROFR should not be viewed as a meaningless right offered to satisfy a request by a tenant without giving thought to what it means in for future marketability of the underlying property. It could definitely adversely impact the ability to sell the property in the future. If you try to rely on a term sheet or letter of intent to sidestep this problem, the holder of the refusal right may argue that the final contract with a third party contains material terms not contained in the term sheet. Any failure of the rights holder to exercise its ROFR might, therefore, not be deemed a waiver of the right. The holder might contend it should be entitled to another chance to purchase when the full terms are disclosed.⁴

• *Ability to Sell* — The existence of a refusal right will typically adversely affect the owner's ability to sell the burdened property as long as the refusal right is outstanding. But its effect may be more profound. If the rights holder exercises its refusal right but the purchase agreement contains a diligence period, will the rights holder obtain the same diligence period? Unless this point is specifically addressed in the ROFR grant, the rights holder will have all of the rights of the prospective purchaser even though it may have

occupied the property for many years before the refusal right was triggered. Such a diligence period may allow the rights holder the ability to exercise the ROFR and tie up the property for 30, 60, or 90 days, then cancel prior to the expiration of the diligence period, thereby potentially derailing a prospective sale.

What about the effect of a tenant's failure to close the purchase if it exercises the refusal right, for example, because of its inability to obtain necessary financing?⁶ In such an event, you may have lost two potential purchasers and tied up the property for a substantial period of time in the process. You can vet the financial ability of a third-party purchaser, but even if the rights holder originally had a triple A rating, by the time the right is triggered, its financial situation may have changed substantially. In this context, think of Kmart or Sports Authority and how their financial wherewithal dramatically declined over the years. In addition, the failure of the rights holder to close on its purchase offer after the exercise of a ROFR may affect the underlying lease. For instance, Florida courts have held that upon an exercise of an ROFR, the lease containing the ROFR is extinguished.⁶ But the failure to exercise a ROFR does not extinguish other rights tenant may have under its lease.⁷

• *Title Issues* — Any tenant holding a refusal right will want to record a notice of such right in the public records. This recording will not have any title effect on an existing lender since the refusal right will be subordinate to the mortgage, although it may very well violate a covenant in the landlord's loan agreement. Such recorded notice will, however, likely substantially and negatively affect the owner's subsequent ability to finance or refinance the property. Although perhaps not a practical problem, the holder of the refusal right might be able to acquire the property free and clear of the mortgage. If the mortgagee forecloses, the rights holder might be able to preempt a sale by the mortgagee to a third party. Any lender will no doubt

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require that either the refusal right be extinguished or expressly subordinated to all of its rights under the loan documents. Unless you have provided for this in the ROFR, your ability to accomplish a subordination may be limited or costly.

Rights of First Offer

Assessing the problems in granting a first refusal right, you may conclude that a right of first offer, or a ROFO, may be safer. Such a right entails offering the property to the rights holder before it is offered to the general public. The "beauty" in such a preemptive right is that it may be extinguished before the property owner markets the property to others thereby eliminating the negative overhang of a first refusal right in securing purchasers.⁸

• *The Offering Price* — Contrary to what clients may believe to be the case, the rights holder will not permit the property owner to offer the property to the rights holder at one price then sell it in the market at a substantially lower price. Typically, the property owner is limited on a sale to a downside price, but given some flexibility, it can sell typically at 95 percent of the offered price without re-offering the property to the rights holder.

Pricing the property raises issues. How does the property owner know the actual price the property will sell

for without advance marketing? If the offering price is under market, the rights holder might purchase the property and potentially "flip" it at a profit. If the offering price is above market, then the property owner will need to reoffer the property to the rights holder, creating an additional delay in its disposition.

• *The Offering Terms* — An offer consists of much more than the price of the property. Is there a diligence period or financing contingency? What about a contract deposit? How long is the period from contract to closing? What are the conveyance documents and what representations is the seller prepared to provide? It is unlikely, and not typical, that the property owner will be able to reflect all of these terms in the offer. If the final negotiated terms of a sale to a third party look more extensive, would this trigger a reoffering to the rights holder? If such were the case, the process would look very much like a first refusal right. Typically, a first offer right includes only the "primary terms" of the sale: price, closing date, and contingencies, if any. Do the "primary terms" work when the rights holder seeks to exercise its preemptive rights? What if the rights holder insists on a statutory warranty deed but the property owner intended to offer only a special warranty deed? How would the impasse be resolved?

• *Ability to Sell* — You offered the property to the rights holder at \$10 million and the rights holder declined to purchase. The preemptive right allowed a sale for 95 percent of the offered price and you signed a third-party contract at \$9.7 million, well within the 5 percent tolerance. The buyer has just completed due diligence and determined that the building needs a new roof and demands a \$300,000 credit against the purchase price. You are anxious to close and would be inclined to give the \$300,000 credit, but granting the credit would reduce the purchase price below your tolerance level. Reducing the price to \$9.4 million would require you to reoffer the property to the rights holder. If you do so, you may

force the current buyer to cancel the contract or, worse, sue you for breach of its sale contract. If you refuse the credit to the prospective purchaser and, therefore, reoffer the property to the rights holder at \$9.4 million, what happens if the rights holder passes? Now you have no contract unless the buyer is willing to restate. But while you were giving the rights holder 30 days to respond to the lower offering price, the buyer may have found another property.

Extending the buyer's diligence period while you reoffered the property to the rights holder may not work. If the rights holder elected to purchase and you still had an outstanding contract with the buyer, the buyer might elect to waive its demand for a \$300,000 credit and become obligated under the contract. You would then be under two separate agreements to sell the property to two separate buyers.

Another scenario may be that the rights holder exercises the right to purchase but thereafter fails to close. What are the consequences on the rights holder's lease or other interest in the property?⁹ Or, even worse, what if the rights holder exercises its purchase right and there is a dispute as to whether the rights holder properly complied with the terms of the preemptive right as discussed below, since all of the terms of the purchase were not spelled out?

• *Manner of Exercise* — How does the rights holder exercise its preemptive right? Remember, here we are not dealing with a full purchase agreement as with a right of first refusal. The preemptive right contains only "primary terms." If the rights holder agrees to the "primary terms," is that sufficient to constitute an enforceable contract?¹⁰ One may try to draft around this problem by reference to a form contract, which may or may not work in a particular situation. The failure to agree on the full terms of the sale may result in the property becoming mired in litigation.

• *Title Issues* — The issues with a first-offer right are similar to a first-refusal right, assuming the rights holder will record some form of

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notice of such rights, you may have similar problems with an existing mortgagee or a future mortgagee.

Turn the Beat Around: Obtaining a Preemptive Right

Let's change the facts so that your client is All Brands USA, the prospective tenant seeking a preemptive right. You have been informed by your client that it looks upon the current ownership of Mallchester Mall favorably. But, based on the fact it will be making a substantial investment in tenant improvements to the store, it wants to protect itself against a change in fee ownership of the store, especially to property owners who also run competing businesses. It has decided that obtaining a preemptive right to purchase will protect its investment. Or will it? The comments below address both forms of preemptive rights.

• *The Property* — As noted above, All Brands USA wants to control its store and not necessarily the entire shopping center. It might have the financial capacity to purchase the store, but the purchase price for the shopping center may present a larger financial burden than its appetite. If it convinces Mallchester Mall to subdivide the property so its store is a separate parcel, it may still face the problem if the offer is for the shopping center or a portfolio of shopping centers.¹¹

• *The Trigger* — Your client does not control the timing for the exercise of the refusal right. The control of this purchase option is solely within the control of the landlord. The mall owner can elect to activate the option at a time not conducive to tenant's exercise. What happens if the mall owner triggers the right when All Brands USA is in the middle of some financial transaction, such as a public offering or corporate financing, and it lacks the ability, financial or otherwise, to make the purchase? Your client does not have the ability to delay or defer the exercise of its purchase right. Typically, the consequence of the failure to exercise the preemptive right when the trigger has been activated is the loss of the right entirely.¹²

• *Ability to Purchase* — If the preemptive right is in the nature of a right of first offer and the offer terms are skeletal, exercising the right might be a challenge if your client and the owner do not agree on the balance of the purchase terms. Will your client have time to secure financing, have the ability to obtain estoppel letters from the other tenants in the shopping center or representations on the leases? Does the landlord have to provide "typical" representations and warranties on the property and its ability to execute the necessary documents?

If the preemptive right is part of a right of first refusal, you may have a full contract, but what about a sufficient period to obtain financing? The buyer may be an investment fund that does not need financing. With a short fuse to closing, it may be impossible to obtain financing within the period provided for closing.¹³ Will a substantial deposit be needed immediately to match the third-party agreement? Will the funds be available immediately? Your landlord and the prospective purchaser may have been negotiating their purchase contract for months so that the purchaser has been afforded sufficient time to prepare itself financially for the contract deposit and funds needed at closing. Your client may have 30 days or less to make such preparations. If your client exercises

its preemptive right but, for any reason fails to close, it may have sacrificed its leasehold interest in the process.

Finally, be aware that preemptive rights are not absolute and may be defeated in certain situations.¹⁴

Conclusion

If your head is spinning and you never want to deal with preemptive rights, our objective has been achieved. Our experience is that preemptive rights sound great but never or rarely work in practice. They are a futile source of litigation. In addition, they may present a land mine for buyers purchasing leased property without reviewing all of the leases. Florida courts have held that a tenant's possession puts a purchaser on inquiry notice of possible rights under the tenant's lease.¹⁵

In many cases, clients work around such rights and reach an accommodation each can live with notwithstanding the preemptive rights. Other times, such rights can turn a real estate transaction into a litigation nightmare.¹⁶ While you may not be able to dissuade your client from granting or requesting such rights, you will now be in a position to raise the danger signals when the subject arises and explain why granting a preemptive right might be wrong. □

¹ Florida adheres to the minority rule that ROFRs are not subject to the rule against perpetuities, *Old Port Cove Holdings v. Old Port Cove Condo Ass'n One*, 988 So. 2d 1279 (Fla. 2008). In addition, ROFRs are not deemed an unreasonable restraint upon alienation if the option price is at market or appraised value or if the option is for a limited duration. See *Iglehart v. Phillips*, 383 So. 2d 610 (Fla. 1980); *Sandpiper Dev. & Const., Inc. v. Rosemary Beach Land Co.*, 907 So. 2d 684 (Fla. 1st DCA 2005).

² There is Florida caselaw indicating a bulk transaction that combines property not subject to a ROFR with property that is subject to a ROFR does trigger the ROFR. See *In re Sixty Sixty Condo Ass'n, Inc.*, 574 B.R. 773 (Bankr. S.D. Fla. 2017). However, a ROFR will not be defeated by a bulk sale which includes, as part of the property, a property subject to a ROFR such that the holder of a ROFR would be compelled to purchase more property than is the subject of the ROFR. See

Whyhopen v. Vita, 404 So. 2d 851 (Fla. 2d DCA, 1981); and *Holston Investments v. Lanlogistics*, 664 F. Supp. 2d 1258 (S.D. Fla. 2009). These cases, however, fail to shed light on how to value an individual property as part of a bulk purchase.

³ *Cent. Properties, Inc. v. Robinson*, 450 So. 2d 277 (Fla. 1st DCA 1984), *quashed in part*, 468 So. 2d 986 (Fla. 1985).

⁴ *Id.* When essential elements of a purchase contract remain open for further negotiation and agreement, no meeting of the minds may have occurred yet to trigger the ROFR.

⁵ In *Holston Investments Inc. v. Lanlogistics, Corp.*, 664 F. Supp. 2d 1258 (S.D. Fla. 2009), the court ruled that a party desiring to exercise its ROFR must show that it is financially capable to consummate the transaction. Additionally, if a holder of a ROFR is not financially capable of matching the same terms and conditions offered by a third-party purchaser, then such holder is not ready, willing, and able to exercise its ROFR and its claim for such a right fails.

⁶ *Keys Lobster v. Ocean Divers*, 468 So. 2d 360 (Fla. 3d DCA 1985). See *Allegro at Boynton Beach, LLC v. Pearson*, 227 So. 3d 1288 (Fla. 4th DCA 2017).

⁷ In *Barco Holdings v. Terminal Investment*, 967 So. 2d 281 (Fla. 3d DCA 2007), the court held that the failure to exercise an ROFR did not affect a separate option to purchase under the lease. See also *Conroy v. Amoco Oil*, 374 So. 2d 561 (Fla. 1st DCA 1979); *Am. Oil Co. v. Ross*, 390 So. 2d 90 (Fla. 3d DCA 1980). Additionally, an ROFR is not affected by termination of the underlying contract.

⁸ Note that Florida courts have held that a ROFO is not an unreasonable restraint on alienation. *Smurfit-Stone Container Enterprises v. Zion Jacksonville Ltd. P'ship*, 52 So. 3d 55 (Fla. 1st DCA 2010).

⁹ See notes 6 and 7.

¹⁰ See note 4.

¹¹ See note 2.

¹² See *Holston Investments Inc. v. Lanlogistics, Corp.*, 664 F. Supp. 2d 1258 (S.D. Fla. 2009).

¹³ For a holder of an ROFR to exercise its option, the holder must tender an unqualified acceptance of all terms of the offer without modification. See *Coastal Bay Golf Club, Inc. v. Holbein*, 231 So. 2d 854 (Fla. 3d DCA 1970); *Anderson v. Draddy*, 458 So. 2d 803 (Fla. 4th DCA 1984); *Cent. Properties, Inc. v. Robinson*, 450 So. 2d 277 (Fla. 1st DCA 1984), *quashed in part*, 468 So. 2d 986 (Fla. 1985). Further, when the holder of an ROFR attempts to exercise its right, but adds or deletes terms and/or conditions that render the offer different than that submitted by the third-party prospective purchaser, the ROFR has not been properly exercised. See *Castelli v. Castelli*, 159 So. 3d 271 (Fla. 4th DCA 2015). However, the exercise of an ROFR need only be identical to the offer terms, which are essential. See *Schwey v. Vara*, 674 So. 2d 935 (Fla. 4th DCA 1996); *Int'l Christian Fellowship, Inc. v. Vinh on Prop., Inc.*, 954 So. 2d 1214 (Fla. 4th DCA 2007). Addition-

ally, it is not necessary for the holder of an ROFR to specifically quote the terms of the third-party offer it is agreeing to match of the third-party purchaser's contract in order to properly exercise its ROFR; rather, an attempted exercise that is silent on the terms of the acceptance implicitly adopts the terms of the third party offer it seeks to match. See *Castelli v. Castelli*, 159 So. 3d 271 (Fla. 4th DCA 2015); *7-Eleven, Inc. v. Shin, LLC*, 961 So. 2d 977 (Fla. 4th DCA 2007).

¹⁴ See *Pecora v. Berlin*, 62 So. 3d 28 (Fla. 3d DCA 2011). Receiver appointed to operate and sell properties when former owners died in a murder/suicide event defeated right of first refusal acquired by plaintiff.

¹⁵ *Denco v. Belk*, 97 So. 2d 261 (Fla. 1957).

¹⁶ See, e.g., *Allegro at Boynton Beach v. Pearson*, 227 So. 3d 1288 (Fla. 4th DCA 2017); *Pearson v. Fulton*, 497 So. 2d 898 (Fla. 2d DCA 1986); *Green v. First American Bank & Trust*, 511 So. 2d 569 (Fla. 4th DCA 1987); *Anderson v. Draddy*, 458 So. 2d 803 (Fla. 4th DCA 1984).

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