

# **EASIER SAID THAN DONE: RIGHTS OF FIRST OFFER, RIGHTS OF FIRST REFUSAL AND OPTIONS**

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# “Pre-emptive” or “Preferential” Rights (“PPR’s”)

- Rights of First Offer (ROFO)
- Rights of First Refusal (ROFR)
- Options

Often confused by lawyers and judges  
but never by ACREL Fellows

Option, ROFO, ROFR: to play or not to play?



# ROFR Pros and Cons

- In theory, the market sets the price.
- Grantor is never forced to sell.
- Holder gets a cost-free right.
- For grantor, a ROFR is a marketing drag.
- “Triggering” disputes are common.
- “Matching” disputes are common.
- Unique third-party offers invite disputes.
- **The future is uncertain & risk of litigation high.**

# The future is easy to predict



# ROFO Pros and Cons

- Grantor never forced to sell.
- Holder gets a cost-free right.
- Matching & triggering disputes less likely.
- Gentler impact on marketing.
- First offer strategies are tricky.
- **The future is uncertain & risk of litigation high.**

# Important to keep your options open?



# Option Pros and Cons

- Terms set in advance = fewer disputes.
- Controlling legal principles are relatively clear.
- Grantor is bound to an irrevocable offer.
- Transactional costs may be high.

# What the economists say



"They've led our breakthroughs in gaming theory."

# What the economists say

- The King could just assume a horse.
- ROFRs (and probably ROFOs):
  - generate disputes,
  - discourage offers,
  - deflate prices,
  - favor holders.
- Net costs often outweigh benefits.
- Grantors generally should prefer ROFOs.
- Commitment to auction an alternative?

# An option, a ROFR, a contract of sale, or ????



# A ROFR, An Option, or Something Else Entirely? *Only the judges know!*. . .

- Judicial labeling may have far-reaching consequences.
  - Valuable rights “construed” out of existence
  - Unexpected obligations imposed
  - Performance noncompliant *ex post facto*
- Judicial process can be inconsistent, arbitrary and unpredictable.
  - Judicial confusion
  - Sketchy drafting
  - Influenced by whimsical factors
- Parties are stuck with a deal they never intended.

# THE “MODERN” JUDICIAL APPROACH

- Case study: contract of sale v. option
- Traditional rule: if bilateral, it's a sale contract even if it has contingencies
- Modern trends have muddied the waters
- “Option” label now affixed to any contract where seller accepts stipulated damages if buyer fails to perform
- “Modern” rule is quicksand for the unwary practitioner

A photograph of a person parachuting into a body of water. The parachute is a large, light-colored canopy with multiple lines. The person is in the water, and the shoreline is visible on the left with a rocky, log-covered bank. The background is a dense line of green trees under a clear blue sky.

Litigators

PPR Holder

Beware What You Write  
(Words CAN Hurt You)

# How easy it is to draft a bad clause

- If Grantee enters into a good faith, bona fide contract to sell or transfer any portion of the Property other than Grantee's Building or the land associated therewith to any third party that are not members of the Grantor entity ( "Grantor Members"), then Grantee must promptly send a complete copy of the sale contract, or a complete summary of the terms of any oral sale contract, to Grantor Members, together with a notice advising them that unless they exercise the purchase option and right of first refusal within 90 days, then Grantee intends to sell or transfer the identified property to the third party in accordance with the terms of the sale contract attached to the notice.

# What is an ‘insurable interest’?

- Identification of the type of interest – a “rose” is not always a “rose”
  - Option
  - Right of First Refusal
  - Right of First Offer
- Interest in real property vs. contractual right
- Recordation

# Types of Title Insurance Coverage

- Owner's policy:
  - Schedule A – modified to show insured interest is an option
  - Leasehold owner's policy – if option is contained as part of a lease
- With
  - Additional exceptions
  - Modification of measure of loss or damage under policy
- Endorsements
  - ALTA 46
  - ALTA 9.6-06
  - State Specific Endorsements

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# BONA FIDE OFFER/SALE

*(We know it when we see it.)*

- Many ROFRs require “bona fide” third party offer
- Defined as:
  - made with actual intention to purchase on stated terms, and
  - could ripen into a valid and binding contract
- “Extra” terms may be OK if:
  - commercially reasonable
  - imposed in good faith
  - not designed to defeat PPR

# Do you remember....

- The statute of frauds
- The rule against perpetuities (RAP):  
Restatement says RAP does not apply  
—problem solved?
- Unreasonable restraints on alienation:
  - An important limit on options;
  - Restatement says ROFRs and ROFOs  
barely restrain transfer—problem solved?
- The “stranger to the deed” rule

# Package Deals



# Package Deals

*(More is not always better)*

- Generally, no obligation for assets beyond ROFR
- Exception for related assets if offer is “bona fide”
- PPR holder has duty to investigate terms
- PPR holder must respond on time
- PPR holder may need to “tender”
- Anticipate potential “package deal” scenarios

# Strict Compliance ... or not

- Stricter for exercise than for other terms?
- Ignore immaterial terms?
- Monetize non-monetary terms?
- Manipulate terms against holder or 3d parties?
- How much do good faith & fair dealing matter?

# Impact on Title



# Impact on Title

- Difficulty refinancing or conveying
- What constitutes a “transfer”?
  - Black’s definition of “transfer”: “the sale and every other method, direct or indirect, of disposing of or parting with property or with an interest therein, or with the possession thereof, or of fixing a lien upon property or upon an interest thereon.”

# Impact on Title

- Difficult or impossible to establish a waiver of the right:
  - Was notice proper and in accordance with the terms of the agreement?
    - Method of transmittal
    - Form of notice
    - Receipt by holder of interest
- How do you establish no response?
- One Time vs. Continuing Right- Use it or lose it?

# Enforcement



# COMMON PPR ENFORCEMENT ISSUES

*(If you can think of it, someone has argued it)*

- Enforceability
- Effectiveness
- Conditions precedent
- Landowner's performance
- PPR holder's performance
- Waiver or bad faith
- Remedies

# Saturday Roundtables

## **DRAFTING RIGHTS OF FIRST OFFER, RIGHTS OF FIRST REFUSAL AND OPTIONS**

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