



Shopping Center Legal Update

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Right of First Refusal to Purchase: Convenience Store's Exercise Was Anything But Convenient

Eric D. Rapkin*

Akerman Senterfitt

Fort Lauderdale, FL

Commercial lease agreements, in particular those dealing with single-user sites as opposed to leases in a multi-tenant project, sometimes contain a provision(s) in which the landlord grants the tenant a right of first refusal ("ROFR") to purchase the property from the landlord by matching an offer for the property that the landlord wants to accept. While these provisions may seem straightforward, as they typically require the tenant to match the terms of the offer, a recent Florida appellate case highlights how even seemingly clear language can result in a landlord being unable to sell its property until the legal wrangling is completed.

In *7-Eleven, Inc. v. Stin, L.L.C.*, 961 So.2d 977 (Fla. 4th DCA 2007), the Florida District Court of Appeal for the Fourth Circuit reversed a lower court's finding that the tenant had not properly exercised its ROFR. In this case, 7-Eleven's lease, which was entered into in 1974, contained the following ROFR clause:

If during the term of this lease, or any extension thereof, Lessor shall receive a bona fide offer to purchase the demised premises, which offer is acceptable to Lessor, Lessor agrees that Lessee shall have and is hereby granted an option to purchase the demised premises upon the same terms and provisions. Lessor agrees immediately after receipt of such offer to give Lessee notice in writing of the terms and provisions thereof, and that Lessee may exercise its option to purchase said property at any time within twenty days after such notice is received by Lessee. If Lessee shall elect to exercise such option it shall do so by giving notice in writing to Lessor within such twenty-day period and a contract of sale shall be executed by the parties and title closed within a reasonable time thereafter.

In 2004, the landlord and a third party signed an agreement whereby the landlord would sell the property for \$2,270,000. Among other provisions, the agreement provided that the buyer would also enter into a three-year lease that would have a monthly rent of \$10,000. The closing was to be at the end of the lease. The day after the agreement was signed, the landlord notified 7-Eleven, in accordance with 7-Eleven's lease, that the landlord had received a "bona fide offer" and that 7-Eleven had 20 days to elect to purchase the property under the same terms and conditions contained in the offer.

Upon receiving the letter, 7-Eleven sent a response, stating that 7-Eleven was exercising its right to purchase the captioned property for \$2,270,000, and that within the next few days a contract would be prepared and forwarded to the landlord. The landlord, however, rejected 7-Eleven's first proposed contract, which followed 7-Eleven's exercise letter, stating:

[T]here [were] a number of essential terms in the [purchase] agreement which 7-Eleven chose not to match in its offer. These terms include, but are not limited to, the net consideration which would be realized by the seller under the [purchase] contract versus that offered by 7-Eleven, the availability of the deposit to the seller, assessment of closing costs, allocation of risk between buyer and seller in the event of condemnation or casualty prior to closing, and the extent of seller's and buyer's remedies in the event of the other party's default. Due to the above

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differences in the contract proposals, the owner must reject 7-Eleven's offer as not satisfying the requirements of the [ROFR] and will now proceed with the [third party] contract.

The day after the landlord rejected the offer, 7-Eleven informed the landlord that it was "prepared to match the terms, as outlined in the Purchase Agreement between [the landlord], as Seller and [the third party], as buyer" Thereafter, 7-Eleven sent a follow-up letter reaffirming that "7-Eleven [was] prepared to meet all material terms of the [third party] agreement in connection with its election to exercise its ROFR under its Lease Agreement." This letter also said that enclosed was a "revised Purchase Agreement." According to the landlord's attorney, this version included the material terms. But after receiving 7-Eleven's second contract, the landlord sought declaratory relief, requesting that the trial court determine that 7-Eleven did not properly exercise its ROFR, relying on the deficiencies of the first proposed contract.

7-Eleven contended that its second proposed contract cured any deficiencies in the first contract. According to 7-Eleven, the ROFR contemplated a three-step process, as follows: (1) once the owners received a suitable offer, they were obligated to provide 7-Eleven with written notice; (2) 7-Eleven had 20 days to inform the owners of its decision to purchase the property; and (3) 7-Eleven and the owners were obligated to enter into a contract within a reasonable time period.

Each party (the landlord, its third-party buyer and 7-Eleven) moved for summary judgment. The trial court granted summary judgment in favor of the third-party buyer, finding that 7-Eleven's first proposed agreement had material differences because it did not contain a three-year lease provision, failed to require a deposit and was silent as to the sharing of responsibility in the event of condemnation. Thus, because 7-Eleven's first proposed agreement failed to meet the essential terms, 7-Eleven failed to exercise the ROFR properly; and, having granted summary judgment in the third-party buyer's favor, the trial court subsequently declared that 7-Eleven's ROFR expired and that the third-party buyer had an enforceable purchase agreement.

On June 20, 2007 (approximately two-and-a-half years after the landlord and the third-party buyer signed the original purchase contract), the appellate court reversed the trial court, concluding that, *under the specific facts in this case*, 7-Eleven properly exercised its ROFR by submitting its letter exercising its right to purchase the property, and submitting the second proposed agreement.

The appellate court first noted that:

this factual scenario is not typical because the [third party] contract contemplated the operation of a restaurant and contained provisions to that end, such as additional construction and parking. These conditions, which the trial court correctly recognized did not have to be matched by 7-Eleven, made the exercise of the [ROFR] by 7-Eleven more complicated than if the property were going to be used for the same purpose by both offerors. Because of this difference in uses, we conclude that 7-Eleven's first proposed contract should not have been 7-Eleven's only opportunity to match [the third party's] offer.

In its opinion, the appellate court first stated that "[c]ontracts should receive a construction that is reasonable, practical, sensible, and just. *Doctors Co. v. Health Mgmt. Assocs., Inc.*, 943 So.2d 807, 809 (Fla. 2d DCA 2006), *review denied*, 956 So.2d 455 (Fla. 2007)." The court went on to state that:

[i]n its letter exercising its [ROFR], 7-Eleven cited to [the ROFR provision] of the subject lease and the letter sent by the [landlord]. Thus, 7-Eleven, by invocation of [the ROFR provision of the lease], was agreeing to the same material terms as the contract between the [landlord and the third-party buyer]. ***It was not necessary for 7-Eleven to parrot the terms of the [third party] contract because, by invoking the other two documents, 7-Eleven was essentially agreeing to the terms of the [third party] contract. It is of no import that other non-material terms remained to be negotiated.*** See, e.g., *Am. Capital Network v. Command Credit Corp.*, 707 So.2d 874 (Fla. 4th DCA 1998); *Hous. Auth. of City of Fort Pierce v. Foster*, 237 So.2d 569 (Fla. 4th DCA 1970); *Bluevack, Inc. v. Walter E. Heller & Co. of Fla.*, 331 So.2d 359 (Fla. 3d DCA 1976). (*Emphasis added.*)

The court concluded its decision by stating that:

under these specific facts, 7-Eleven properly exercised its [ROFR] by sending the letter and the second contract, which satisfied the objections to the first proposed contract. Although we can see how the trial court concluded to the contrary, based on precedent, in this case, it would have been unreasonable to require 7-Eleven to have only one opportunity to proffer a formal contract because the [third party] offer contemplated a different use and some conditions were irrelevant if 7-Eleven purchased. Accordingly, we must reverse and remand for entry of a final declaratory judgment in favor of 7-Eleven. (*Emphasis added.*)

In analyzing this decision and other reported decisions construing an ROFR arising out of a commercial lease agreement, an initial thought is that the landlord has been delayed by years in selling property due to the existence of this seemingly innocuous right in favor of the tenant. By including an ROFR in a lease, a landlord is likely thinking that it will quickly sell its property on the terms it wants to accept to one of two buyers: either the third-party offeror or the tenant. And, the thinking goes, because the price and all terms will be the same no matter which one buys the site, the landlord will not be harmed by granting the right.

So, it is up to the attorney representing the landlord in the negotiation of the lease agreement to bring to the landlord's attention the many potential pitfalls of granting an ROFR to a tenant.

First, before even considering the specifics or the mechanics of the ROFR, the landlord should understand that by simply granting an ROFR to a tenant, the landlord is creating the very real possibility that it will chill interest in third-party buyers that may have otherwise entered into negotiations with the landlord for the purchase of the property. If potential buyers know that an ROFR exists in favor of the tenant, how many of them will expend the time and effort—and incur the expense of doing the initial due diligence to arrive at an acceptable purchase price and negotiating a purchase agreement (or even a letter of intent)—knowing that the tenant of the property has the ability to preempt the buyer's deal and purchase the property out from under the buyer? That possibility puts the landlord that wants to sell the property in the unenviable position: The landlord must choose whether to disclose to potential buyers up-front that the tenant has an ROFR. Any deal that is reached will be subject to the tenant's ability to exercise its ROFR and preempt the buyer's ability to purchase the property.

Or, the landlord may choose to hide the fact that an ROFR exists until the landlord and the buyer are about to sign the purchase agreement, with the hope that the buyer, although angry at finding this out so late in the process, will be willing to wait for the tenant to decide whether to exercise the ROFR. Even if the landlord does not mention the ROFR to the potential buyer in the initial stages of the buyer's analysis of the transaction and negotiation of a purchase agreement, the buyer's attorney may ask for a representation that there are no options or rights in favor of any third parties to purchase the property. At that point, the landlord must disclose the ROFR and run the risk that the buyer will promptly walk away, incensed at the landlord's failure to disclose the existence of the ROFR up-front.

Second, the landlord must decide whether the tenant will be required to exercise its ROFR as a mirror image of the third-party offer, effectively matching each and every term and condition of the offer. Or, will the tenant be required to match only the material terms of the offer? The answer likely depends on which state's law governs the lease. In the *7-Eleven* case, the Florida court states that the tenant only need match the offer on the same material terms. However, see *West Texas Transmission, L.P. v. Enron Corp.*, 907 F.2d 1554 (5th Cir. 1990), in which the Fifth Circuit, in construing whether the party that held an ROFR properly exercised its right, essentially required a mirror-image match of the offer, stating that:

[w]hether or not a particular contract term is material is not the standard by which we judge whether an acceptance which rejects that term is a valid exercise of the right of first refusal. Like the acceptance of any other offer, the exercise of an option, must be 'unqualified, absolute, unconditional, unequivocal, unambiguous, positive, without reservation and according to the terms or conditions of the option.'

See also Kevin L. Shepherd, *Rights of First Refusal/Poison Pills and Bad Faith*, Probate & Property, May/June 2007, 52.

Another potential pitfall for a landlord in granting an ROFR concerns the potential buyer's due-diligence period. In most purchase agreements for the sale of commercial property, the buyer is given a period of time (very often a minimum of 30 days) following the execution of the purchase agreement within which to conduct its due diligence and then elect, in its sole discretion, whether to terminate the purchase agreement, to receive its deposit back and walk away, or to proceed with the transaction. With the knowledge that the purchase agreement contains this "free-look" due-diligence period, a tenant has a strong incentive to exercise its ROFR, knowing that it is not really bound to purchase the property, inasmuch as the tenant can terminate for any reason or no reason at the end of the due-diligence period.

Moreover, the landlord would be well-advised to consider the timing of this scenario. Assume that the ROFR provision in a lease agreement gives the tenant 20 days to notify the landlord of the tenant's election to buy the property on the same terms as those contained in the third-party offer, and assume that the third-party offer has a 30-day due-diligence period. This means that the landlord could be in a position of waiting 50 days to know if the tenant is actually going to buy the property. As a practice pointer, if an ROFR must be included in a lease agreement, the landlord's counsel might consider including language similar to this:

Any inspection period, or due-diligence period, or other "free-look" provisions of such *bona fide* offer pursuant to which the purchaser would have the right to terminate a purchase-and-sale agreement in its sole discretion shall not be applicable to Tenant, it being acknowledged that Tenant shall conduct any due-diligence inspections during the 20-day period within which Tenant must elect to exercise its right of first refusal.

Sometimes, when a landlord (who likely granted the ROFR without too much analysis or thought) wants to sell the site some years later but realizes that an ROFR exists, the landlord may try to figure out a way to "game" the system such that the tenant will be dissuaded from exercising its ROFR and the landlord can quickly proceed with the transaction with the third-party buyer. Courts, however, have recognized that including "poison pill"-type provisions in the offer that the tenant is required to match may be held to be an act of bad faith and will not be permitted. See, e.g., Shepherd, *supra*, and the cases cited therein.

This article does not set forth every potential issue that should be considered in drafting an ROFR to be set forth in a lease. Some other examples of issues to consider are whether the ROFR should address if it applies to (1) the landlord's sale of the equity interests in the landlord as opposed to the sale of the real property, (2) exceptions for sales by the landlord to affiliates and a sale of the property as part of an overall merger or consolidation by the landlord, and (3) whether the ROFR is personal to the original tenant or can run to an assignee.