OPTIONS AND RELATED RIGHTS WITH RESPECT TO REAL ESTATE: AN UPDATE*

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Editors' Synopsis: Parties that do not carefully consider and draft options, right of first refusal, and other similar rights when creating or transferring property interests can make unexpected problems for themselves. This article examines the characteristics that differentiate options, rights of first refusal, and other related rights and describes how these manifold rights interact with each other and with other law, including the statute of frauds, the rule against perpetuities, and bankruptcy law. Throughout, the author emphasizes the need for accurate and conscientious expression of the parties' intention and has included in the appendices to the article several forms that might aid practitioners in accomplishing that end.

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I. INTRODUCTION

If they are not careful, parties who wish to incorporate options to purchase, rights of first refusal, or similar rights into legal documents creating or transferring real property interests (including leases and purchase agreements) can create unwanted and unanticipated problems when negotiating and drafting such provisions. The parties should never take these options and related rights lightly, and they should clearly and comprehensively negotiate and draft these provisions to reflect their own intentions and expectations. This article will review and analyze the various issues that arise in connection with options and related rights in real estate, examine the existing case law in connection with such issues, and suggest strategies for eliminating (or at least minimizing) the problems that may occur.

II. IMPORTANCE OF CLEAR EXPRESSION OF THE PARTIES' INTENTION: *STUART V. D'ASCENZ*

A Colorado appellate court decision clearly illustrates the dangers of not assuring that the language in a lease clearly expresses the intentions of the parties with respect to an option to purchase or related right. In *Stuart v. D'Ascenz*,[1] the Colorado Court of Appeals ruled that a lease provision providing that the tenant had the right of first refusal for a specified price with respect to a sale of the property granted only a right of first refusal and not an option to purchase.

The facts in this case were straightforward. The plaintiff, who owned and operated a bar in Denver, Colorado, agreed to sell the bar to the defendant for $125,000.[2] The parties entered into two agreements in connection with the transaction: (1) a purchase agreement for the sale of the bar, and (2) a lease for the property (executed five weeks after the purchase agreement), whereby the plaintiff would continue to operate the bar.

The lease contained the following clause: "Leasee [sic] has the 1st right of refusal on the property for a period of (2) calandar [sic] year term from the start of this lease. The purchase price shall be $160,000."[3]

Approximately one year after the execution of the lease, the plaintiff offered to purchase the property for $160,000; the defendant refused this offer. The plaintiff then sued for specific performance, claiming that the lease clause quoted above granted her an option to purchase. The trial court agreed with the plaintiff, holding that the language in the lease clause evidenced the intention of the parties to grant the plaintiff an option to purchase the property.[4]

The appellate court reversed the holding of the trial court, finding that the lease unambiguously provided the plaintiff with only a right of first refusal.[5] The appellate court explained the distinction in law between an option and a right of first refusal:

> [A]n option to purchase gives the holder the power to compel the owner to sell the property regardless of the owner's desire to do so; in contrast, a right of first refusal does not give the holder the power to compel the owner to

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[1] 22 P.3d 540 (Colo. App. 2000).

[2] *See id.* at 541.

[3] *Id.*

[4] *See id.*

[5] *See id.*

> sell but merely requires the owner, when and if he or she decides to sell, to offer the property first to the holder.[6]

The appellate court held that the mere fact that an otherwise unequivocal right of first refusal contained a purchase price did not create an option.[7] Therefore, the court ruled that the lease clause did not create an option because nothing in the clause indicated that the plaintiff had any right to demand conveyance of the property before the defendant indicated his intention to sell it; if the defendant subsequently decided to sell the property, his only obligation would be to first offer it to the plaintiff for the stipulated purchase price of $160,000.[8]

The court's decision in *D'Ascenz*—holding that the language in the lease created a right of first refusal and not an option—is not surprising. The language clearly referred to a right of first refusal, and the statement of the purchase price—although certainly not a model of clarity—did not alter this fact.

Combining a right of first refusal and a separate option in the same agreement (whether deliberately or inadvertently) is always dangerous.[9] If parties must insert alternative rights into the agreement, their counsel should be careful to clearly and conspicuously spell out in detail the terms of each right and the circumstances under which one or the other will prevail (to avoid an ambiguity that a court must decide).

The *D'Ascenz* court cited law from Colorado and other jurisdictions in support of its holding: "Although options are often linked to stipulated prices, and rights of first refusals (or pre-emptive rights) to third party of-

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[6] *Id.* at 541–42.

[7] *See id.* at 542.

[8] *See id.* The appellate court rejected the plaintiff's argument that certain provisions in the purchase agreement independently created an option right in the plaintiff. The court held that because the lease clause was unambiguous, extrinsic evidence could not alter its meaning. *See id.* The court further held that even if it considered extrinsic evidence as to the terms of the purchase agreement, the evidence showed that although the plaintiff had attempted to negotiate a provision providing both an option right and a right of first refusal, the counterproposal submitted by the defendant—and accepted and signed by the plaintiff—provided only a right of first refusal to the plaintiff. *See id.* Moreover, the court held that because the parties executed the lease later in time than the purchase agreement, "the purchase agreement provisions merged into the unambiguous clause in the lease dealing with the same subject matter." *Id.*

[9] *See* discussion *infra* Part V.

fers, neither stipulated prices nor third-party considerations determine whether a particular clause is an option or a right of first refusal."[10]

Tachdjian v. Phillips[11] provides another example of an ambiguity in language that caused problems for the parties. In *Tachdjian*, the Georgia Court of Appeals ruled that the language in a real estate purchase agreement executed by the parties was ambiguous as to whether it granted solely a right of first refusal or, in addition, created an enforceable option to purchase the property.[12] The court remanded the case for a jury trial to deter-

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[10] *Id.* (citations omitted); *see also* McKinnis v. Fitness Together Franchise Corp., No. 10-cv-02308-RPM, 2010 WL 5056666, at *3 (D. Colo. Dec. 6, 2010) ("A right of first refusal provides the grantee with a contingent option to purchase an asset owned by the grantor if the grantor elects to sell."); Polemi v. Wells, 759 P.2d 796, 798 (Colo. App. 1988) ("[A] preemptive right does not give the lessee the power to require an unwilling owner to sell. It merely requires the owner, if he should decide to sell, to offer the property first to the lessee for the price at which the owner is willing to sell to a third party."); Ferrero Constr. Co. v. Dennis Rourke Corp., 536 A.2d 1137, 1140 (Md. 1988) (Cole, J., dissenting) ("[A] right of first refusal is impotent to put property outside the stream of commerce. The holder of a right of first refusal cannot force the owner to sell the property. Nor can the holder prevent a sale once the owner has decided to sell. The holder of the right is limited to either accepting or rejecting the offer when the owner desires to sell. Moreover, because the right of first refusal in this case is not to be exercised at a fixed price, but is instead based on a price the owner is willing to accept from a third party, the right does not discourage the owner from placing improvements on the property, and the owner is assured of getting the fair market value for his land and added improvements."); Bloomer v. Phillips, 562 N.Y.S.2d 840, 841–42 (App. Div. 1990) ("Unlike an option, which creates a power to compel a sale, a first refusal right 'contemplates a willing seller who desires to part with the property.' Should the seller decide not to sell before the right of first refusal is exercised, 'the selling party has fully complied with its obligations under the first refusal clause by not selling without first making the required offer.' Thus, the selling party is not required to do more than was promised by keeping the offer open even after deciding against the sale. Accordingly, we find that the first refusal offer herein did not become an irrevocable option by operation of law. Nor, in our view, did the parties intend so under the specific terms of the agreement. We recognize that contracting parties, if they so choose, may specifically provide that a first refusal offer must remain open, 'making it an option.' However, that is not the case here. Although the contract provided plaintiffs with an 'irrevocable' right of first refusal, the term 'irrevocable' specifically applied only to the right of first refusal and not to defendants' offer to sell. In our view, the term is unambiguous and to interpret it otherwise in this instance would transform the right of first refusal into an option, a result which was not the intention of the parties and cannot be gleaned from the contract itself. Therefore, plaintiffs were not entitled to relief under the circumstances." (quoting LIN Broad. Corp. v. Metromedia, Inc., 544 N.Y.S.2d 316, 319, 320 (1989)); Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 187 (Tex. App. 1991) ("A right of first refusal, as a preemptive right, requires the property owner to first *offer* the property to the person holding the right of first refusal at the stipulated price and terms in the event the owner decides to sell the property.").

[11] 568 S.E.2d 64 (Ga. Ct. App. 2002).

[12] *See id.* at 65.

mine what the parties actually intended.[13] The right of first refusal in the purchase agreement stated an initial fixed price for a period of years and thereafter a price to "be negotiated between the parties."[14] The holder of the right of first refusal testified that the parties orally stated and agreed to the alleged option to purchase and that the option was part of the consideration for the transaction.[15] The court also was concerned that the agreement stated no triggering event—such as an offer by a third party or the property owner's decision to sell.[16] Furthermore, the court stated that existing Georgia case law "makes clear that if a right of first refusal is to be complete, the parties must supply the triggering term by agreement that informs the parties when such right is operative."[17] The court did not find, however, that the disputed provision constituted an option instead of a right of first refusal; it stated that "the question as to what was intended here, is an issue of fact for the jury to resolve," and it remanded the case for a jury trial on this issue.[18] The court stated that "[i]f the jury finds that the parties intended a right of first refusal (to be triggered by [defendant] offering the property for sale), then [defendant] must prevail."[19]

III. DIFFERENCE BETWEEN OPTIONS AND RELATED RIGHTS

This Part briefly summarizes the differences between options, rights of first refusal, rights of first negotiation, and rights of first offer.[20]

A. Option

An option is the clearest and strongest right that can be granted to give a party flexibility in the future: the holder of the option acquires the right, but not the obligation, to lease, buy, or otherwise control a specified asset in the future.[21] To be enforceable, the option should set forth exactly which asset is subject to the option, the price and terms on which the optionee can exer-

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[13] *See id.* at 67–68.

[14] *Id.* at 65 (internal quotation marks omitted).

[15] *See id.* at 66.

[16] *See id.* at 67.

[17] *Id.*

[18] *Id.*

[19] *Id.* at 68.

[20] See Appendix A for a chart showing the respective advantages and disadvantages of options, rights of first refusal, rights of first negotiation, and rights of first offer.

[21] *See* Metro. Transp. Auth. v. Bruken Realty Corp., 67 N.Y.S.2d 156, 163 (1986) (stating that an option to purchase land "grants to the holder the power to compel the owner of property to sell it whether the owner is willing to part with ownership or not").

cise the option, the date or dates on or between which the option is exercisable, and the corresponding dates for closing or delivery of the optioned asset.[22] The parties to an option or a related right should also be cognizant of the fact that, generally, courts strictly construe the language in options and related rights.[23]

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[22] *See* Wachovia Bank v. Lifetime Indus., Inc., 52 Cal. Rptr. 3d 168, 175 (Ct. App. 2006) ("An option to purchase real property, supported by consideration, is a contract by which the owner of the property (the optionor) gives another (the optionee) the exclusive right to purchase the property in accordance with the terms of the option. An option may provide that it can be exercised only upon the existence of specified facts or the occurrence of specified events. If the specified facts do not exist or the specified events do not occur, then the option cannot be exercised." (citations omitted)); *see also* Straley v. Osborne, 278 A.2d 64, 68 (Md. 1971) ("An option has been defined . . . as 'a continuing offer to sell during the duration thereof which on being exercised by the optionee becomes a binding and enforceable contract.'" (quoting Diggs v. Siamporas, 237 A.2d 725, 727 (Md. 1971))). *See generally* 1 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 5:16 (4th ed. 2007) ("The traditional view regards an option as a unilateral contract which binds the optionee to do nothing, but grants him the right to accept or reject the offer in accordance with its terms within the time and in the manner specified in the option.").

[23] *See* Elderkin v. Carroll, 941 A.2d 1127, 1133–34 (Md. 2008) (requiring "the literal matching of terms in cases involving the formation of binding contracts" and ruling that optionor had no duty to inform optionee that it had failed to properly exercise its option right); Foye v. Parker, 790 N.Y.S.2d 787, 788 (App. Div. 2005) (holding, in an action for specific performance of option, that option agreement did not allow purchase of only a portion of premises described in option agreement); LaPonte v. Dunn, 793 N.Y.S.2d 493, 494 (App. Div. 2005) ("The provisions of an option contract must be strictly complied with, in the manner and within the time specified."); *cf.* Bramble v. Thomas, 914 A.2d 136, 149–50 (Md. 2007) (ruling that while the exercise of an option requires unequivocal acceptance in accordance with the terms of the option, holder of first right of refusal on real property did not have to literally match all terms of triggering third-party offer tendered to optionor, where terms objected to may have been inserted in bad faith to discourage or frustrate rights of pre-emptive holder of right of first refusal); Meccariello v. DiPasquale, 826 N.Y.S.2d 702, 703 (App. Div. 2006) ("If the option agreement does not contain any dates certain for the execution of the contract or for the closing of title, parties are given a reasonable time to tender performance. After a reasonable time has elapsed without one party adhering to the terms and conditions of the agreement, the other party is free to rescind the agreement." (citations omitted)); Lamberti v. Angolillo, 905 N.Y.S.2d 560, 561 (App. Div. 2010) (holding that optionor, expressly and by its conduct, waived its right to insist upon strict compliance with option agreement with respect to time period for exercising option and purchase price of the subject property). *See generally* HARRY D. MILLER & MARVIN B. STARR, 5 CALIFORNIA REAL ESTATE 3D § 11:117 (2011) (describing scope and effect of options with respect to real estate).

B. Right of First Refusal

A right of first refusal is an alternative to an option.[24] Unlike an option, a right of first refusal does not entitle the holder of the right to force the other party to sell or lease the asset. Instead, if and when the other party decides to sell or lease the asset to any third party, the holder of the right of first refusal can require the owner to sell or lease the asset to him for the same price and terms that the owner is willing to accept from the third party. Because the right to first refusal is quite common in real property sales and leases, a large body of case law (and commentary) defines the right and examines the issues that arise in connection with it.[25]

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[24] See Appendix B for a sample form of a right of first refusal respecting an adjoining parcel of land. See Appendix C for a sample form of a right of first refusal clause for insertion in a lease. See Appendix D for a sample form of right of refusal/right-to-offer agreement. Title insurance for rights of an optionee under an option to purchase or a related right in real estate may be available under certain circumstances, subject to the facts of the particular transaction, individual title-insurer underwriting criteria and limitations, and the applicable law and regulations in a particular jurisdiction. The optionee or holder of a related right seeking such coverage should consult its title insurance company as to whether and to what extent such coverage may be applicable and available in connection with such option or related right.

[25] *See, e.g.*, Radio Webs, Inc. v. Tele-Media Corp., 292 S.E.2d 712, 713 n.2 (Ga. 1982) ("A 'right of first refusal' is not an option contract; it cannot be 'accepted' by its holder and it is not required that the price and other terms be specified. A party who grants a right of first refusal promises the purchaser of that right that the promissor will make an offer to sell to the purchaser, or afford the purchaser an option to buy, the property which is the subject of the right, at the price and on the terms stated when the right is granted, or at the same price and upon the same terms as the promissor is willing to accept from a third party. Where no price is stated when the right is granted, the offer of the third party supplies the terms under which the right of first refusal may be exercised." (citing ARTHUR L. CORBIN, 1A CORBIN ON CONTRACTS § 261 (1963))); *see also* Jewish Ctr. for Aged v. BSPM Trs., Inc., 295 S.W.3d 513, 519 (Mo. Ct. App. 2009) ("The person holding the right of first refusal or preemption cannot compel an unwilling seller to sell. Rather, once the seller chooses to sell, the holder of the preemptive right has the option of purchasing the property in accordance with the agreement. The right of first refusal is most frequently given in connection with the sale or lease of real estate. A right of first refusal that is contained in a lease is regarded as a covenant that runs with the land." (citations and internal quotation marks omitted)); Megargel Willbrand & Co., LLC v. FAMPAT Ltd. P'ship, 210 S.W.3d 205, 210 (Mo. Ct. App. 2006); *Bruken Realty Corp.*, 67 N.Y.S.2d at 16 (holding that, in New York, right of first refusal is a well-accepted term and a "preemptive right . . . requir[ing] the owner, when and if he decides to sell, to offer the property first to the [rightholder] so that he may meet a third-party offer or buy the property at some other price set by a previously stipulated method"); BLACK'S LAW DICTIONARY 1350 (8th ed. 2004) (defining *right of first refusal* as "[a] potential buyer's contractual right to meet the terms of a third party's higher offer"); 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 15:6.2A (Patrick A. Randolph, Jr. ed., 2011) ("It has been said that a right of refusal contains no interest in the realty but only a potential

From the standpoint of the holder, a right of first refusal is weaker than an option: it does not set the price for the asset in advance, and it allows the owner of the asset to decide whether and when to sell or lease. These same uncertainties create problems for the property owner, who may resist granting a right of first refusal because of its chilling effect on the property's marketability. Also, brokers may hesitate to list a property that is subject to a right of first refusal unless they also will receive a commission if the holder of the right exercises it and purchases the property.

The scope of the "price and terms" of a third-party offer that the holder of a right of first refusal must meet should be clear, unambiguous, carefully set forth in the right of first refusal and carefully reviewed by any prospective third-party purchasers or lenders.[26]

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right to realty if the right is exercised. In general, a jurisdiction will apply the same general characterization rules to refusal rights that apply to options. Consequently, a jurisdiction that treats options as interests in realty likely will take the same approach here."); Robert K. Wise, Andrew J. Szygenda & Thomas F. Lillard, *First-Refusal Rights Under Texas Law*, 62 BAYLOR L. REV. 433 (2010) (discussing and analyzing Texas law with respect to rights of first refusal and alternatives to first-refusal rights).

[26] *See* Elec. Reliability Council of Tex., Inc. v. Met Ctr. Partners-4, Ltd., No. 03-04-00109-CV, 2005 WL 2312710 (Tex. App. Sept. 22, 2005) ("A right of first refusal, also known as a preemptive or preferential right, empowers its holder with a preferential right to purchase the subject property on the same terms offered by or to a bona fide purchaser. Such a right is distinct from a purchase option, which gives the holder the right to purchase at its election within an agreed period at a named price. If the price is to be the market value of the premises at the time the option is exercised, then no price is specified." (citations omitted)); Cities Serv. Oil Co. v. Estes, 155 S.E.2d 59, 62 (Va. 1967) (ruling that an involuntary transfer of leased premises, such as a foreclosure sale, activated the lessee's right of first refusal against the lessor, and stating that "[a] right of first refusal is distinguished from an absolute option in that the former does not entitle the [buyer] to compel an unwilling owner to sell. Instead it requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the right of first refusal"); *see also* Beneficial Mont., Inc. v. Stanley, No. DV-00-73, 2003 Mont. Dist. LEXIS 2128, at *12–17 (4th Jud. Dist. Mont. 2003) (holding that recorded abstract of settlement agreement entitled "Notice of Right of First Refusal and Conditions Upon Conveyance" provided adequate notice to subsequent parties regarding such right, even though abstract did not mention that settlement agreement granted party with first-refusal right a significant credit against any future bona fide purchase price should it choose to exercise its right of first refusal and required confidentiality of settlement agreement's terms and conditions although abstract contained a provision that settlement agreement was available at local law firm's office); Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 187 (Tex. App. 1991) ("A right of first refusal, as a preemptive right, requires the property owner to first *offer* the property to the person holding the right of first refusal at the stipulated price and terms in the event the owner decides to sell the property."); 25 WILLISTON & LORD, *supra* note 22, § 67:85 (2002) ("Although options and so-called 'rights of first refusal' are sometimes confused, there is a clear and classic distinction: an option must be accepted and then performed within the time limit specified, or if none is

Courts differ as to whether the holder of the right of first refusal must exactly match the third-party offer in all respects or whether the holder of the right need only match the economic equivalent of the third-party offer. This is something that drafters should spell out clearly in the right-of-first refusal clause.[27]

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mentioned, then within a reasonable time, whereas a right of first refusal has no binding effect unless the offeror decides to sell. A right of first refusal, or first right to buy, is not a true option but is a valuable prerogative. It limits the right of the owner to dispose freely of its property by compelling the owner to offer it first to the party who has the first right to buy.").

The grantor of the right of first refusal may not effectively deny the right's holder an opportunity to exercise the right—for example, by ignoring the holder's requests for a copy of the purchase contract with the prospective purchaser or by ignoring the holder's written notice of its intention to exercise the right. *See* Cipriano v. Glen Cove Lodge, 769 N.Y.S.2d 168, 173 (2003) ("Through its failure to act [on the holder's repeated requests for a copy of the purchase contract and ignoring the holder's written affirmations of interest in exercising his right,] the [grantor] has denied [the holder] his bargained-for performance, that is, an opportunity to exercise his preemptive right to buy the property.").

Mortgage lenders may be justifiably concerned when an option to purchase or right of first refusal is contained in a lease on the mortgaged property. *See* Baxter Dunaway, *Purchase Options & Rights of First Refusal*, *in* 1 LAW OF DISTRESSED REAL ESTATE § 11:46 (2011) ("The mortgagee should . . . be wary of a lease which contains an option to purchase [the mortgaged property] for the benefit of a tenant and should consider, at the loan closing, requiring the subordination by the tenant of that option on some reasonable terms generally acceptable to the mortgagee, the mortgagor, and the tenant. The mortgagee should also review any right of first refusal contained in the lease to determine whether the right pertains to a foreclosure sale transfer or a transfer by deed in lieu of foreclosure. The mortgagee should also keep in mind that a tenant may subordinate its option to purchase without subordinating the entire lease.")

[27] *See generally* cases cited *supra* 23. This issue often arises in connection with the payment of brokers' fees and related charges. *See, e.g.*, Hahalyak v. A. Frost, Inc., 664 A.2d 545, 549 (Pa. Super. Ct. 1995) (holding that language contained in right of first refusal was "clear and unambiguous" and that "terms and conditions of any proposed lease" included only economic terms of proposed lease and not agreement of proposed lessee to vacate existing space in the building or agreement of another party to pay "inducement fee" for such vacated space).

In *Reef v. Bernstein*, 504 N.E.2d 374 (Mass. App. Ct. 1987), the court held that when a broker's commission was not due from the seller of the property, the prospective third-party purchaser could not complain that the holder of the right of first refusal did not include an amount equal to payment of the broker's commission in holder's exercise of its right. The court stated the following:

> We agree with the plaintiffs that if a seller is obligated to pay a brokerage commission and remains liable for the commission after a right of first refusal is exercised, the exercise should include the amount of the commission. Where, however, a broker's commission is not due from the seller, the prospective purchaser may not complain that the

Also, a right-of-first-refusal (or option) provision should clearly state whether or not the right is personal to only the present holder of the right or may be assigned to a third party.[28]

Perhaps the most unusual case in the area of assignability is a New York decision involving a last right of refusal (LRR). In *Jeremy's Ale House Also, Inc. v. Jocelyn Luchnick Irrevocable Trust*,[29] the landlord

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> person holding the right of first refusal did not include payment of an amount equal to the broker's commission in his exercise.

Id. at 376. The court also noted that "[h]ad the right of first refusal been drafted more carefully, the problem, of course, would not have arisen." *Id.* at 377 n.5; *see also* Stein v. Chalet Susse Intl., Inc., 492 N.E.2d 369, 372 (Mass. App. Ct. 1986) (holding that if seller received same net price from holder of right of first refusal as he would have received from third party, broker for third party could not require holder of right of first refusal to pay commission); Redfield v. Estate of Redfield, 692 P.2d 1294, 1296 (Nev. 1985); *cf.* Coastal Bay Golf Club, Inc. v. Holbein, 231 So. 2d 854, 858 (Fla. Dist. Ct. App. 1970) (stating that "one offer to purchase matches another only if the essential terms of the offers are identical" and ruling that if holder's exercise of right of first refusal was different in several respects from third-party offer—including failure to pay broker's commission and a smaller cash payment to be paid to the seller—court would enforce owner's right to refuse to accept purported exercise of right of first refusal).

In *C. Robert Nattress & Associates v. Cidco*, 229 Cal. Rptr. 33 (Ct. App. 1986), the court held that the lessee's exercise of its right of first refusal was valid even though the lessee offered a combination of cash and credits instead of the all-cash offer presented by the prospective third-party purchaser, where the seller was willing to accept the reduction in debts as the equivalent of cash. *See id.* at 42 n.2. The court distinguished *Coastal*, as follows:

> Rather obviously, the fact that the owner in the *Coastal* case had *not* found the two proposals equivalent and had not accepted the purported exercise of the right of first refusal and the fact that the proposals purporting to exercise the right of first refusal differed in other material respects from the triggering offer distinguish that case from the case at bench.

Id. at 42 n.2.

[28] *See, e.g.*, *C. Robert Nattress*, 229 Cal. Rptr. at 41 ("An option to purchase contained in a lease of real property is normally assignable."); Shower v. Fischer, 737 P.2d 291, 295 (Wash. Ct. App. 1987) (stating that "absent evidence of intent, options or preemptions are generally construed to be nontransferable" and citing to other cases and commentary for similar conclusion). *But see* 6A C.J.S. *Assignments* § 37 (2004) ("Rights of first refusal are presumed to be personal, and are thus not assignable unless the clause granting the right refers to successors or assigns, or unless the instrument clearly shows that the right was intended to be assignable. A right of first refusal to purchase real property is not assignable if the right does not run with the land but is personal to the grantee.").

[29] 798 N.Y.S.2d 416 (App. Div. 2005). An issue that the parties should expressly address in connection with a right of first refusal is whether, if the grantor of the right fails to sell the property to the third-party offeror after the failure of the holder of the first right of refusal to match the offer, the holder of the first right of refusal retains its right with respect

granted the tenant an LRR in connection with a modification of its commercial lease. The modified lease provided that "in the event of a sale to a third party (not an asset transfer in the family) you [the tenant] will have *last right of refusal* to beat the terms and price by 3% of any bona fide offer."[30] Approximately three months before the expiration of the lease term, the landlord advised the tenant of successive oral offers it received to purchase the property, beginning at $1 million and increasing to $3 million.[31] The

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to future third-party offers. This issue should be expressly addressed in the right-of-first-refusal agreement. *See* ALVIN L. ARNOLD, REAL ESTATE INVESTOR'S DESKBOOK § 9:134 (3d ed. 2011) ("If the landlord fails to sell the premises to the third party after the tenant's refusal to match the offer, the right of first refusal probably is not extinguished and will be triggered by any subsequent offer. However, in order to remove any doubt on this point, the clause in the lease should so specifically provide."); *see also* LEG Invs. v. Boxler, 107 Cal. Rptr. 3d 519, 527 (Ct. App. 2010) (interpreting right of first refusal in tenancy-in-common agreement to permit partition after nonselling cotenant declined to exercise right of first refusal and proposed sale to third party had fallen through); Mobil Oil Guam, Inc. v. Tendido, 2004 Guam 7 ¶ 50 (2004) (holding that inclusion in lease of provision granting tenant period of ninety days to elect to exercise right of first refusal to purchase leased property indicated that the right of first refusal was intended to ripen into an irrevocable option to purchase upon being triggered, and therefore right was exercisable notwithstanding revocation of third-party offer prior to expiration of ninety-day period); Suburban Auto Rebuilders, Inc. v. Associated Tile Dealers Warehouse, Inc., 902 N.E.2d 1178, 1191 (Ill. App. Ct. 2009) (holding that because right of first refusal contained in lease was not made conditional upon continued viability of third-party offer, tenant's right of first refusal under lease was not terminated); *In re* Smith Trust, 745 N.W.2d 754, 761 (Mich. 2008) (ruling that whether a right of first refusal is revocable once the holder of the right receives notice of a third party's offer requires interpretation of the contract language); Glick v. Chocorua Forestlands Ltd. P'ship, 949 A.2d 693, 704 (N.H. 2008) (holding, in case of first impression, that where right-of-first-refusal agreement gave holder irrevocable thirty-day period to exercise such right and third-party contract entered into by owner of property and third party was terminated before end of thirty-day period, right of first refusal was still exercisable for entire thirty-day period); Henderson v. Nitschke, 470 S.W.2d 410, 411 (Tex. App. 1971) (stating that "[t]he determination of the rights of the parties [under a right-of-first-refusal provision] requires an interpretation of . . . the lease"); *cf.* FRIEDMAN, *supra* note 25 ("[T]he tenant's right of refusal during the term does not mean throughout the term, but only until a proper sale to an outsider. But the lease may expressly make the option applicable to subsequent sales."). *But see* LIN Broad. Corp. v. Metromedia, Inc., 544 N.Y.S.2d 316, 322 (1989) (ruling that an offer, once made to the holder of a right of first refusal, is not irrevocable for the period of time set forth in the first refusal clause); *Shower*, 737 P.2d at 293 (holding that right of first refusal only gave holder power to purchase so long as underlying third-party contract was in existence, and right was terminated when third-party contract was extinguished).

[30] *Jeremy's Ale House*, 798 N.Y.S.2d at 417–18 (emphasis omitted and emphasis added).

[31] *See id.* at 417.

tenant orally exercised its LRR for each of the landlord's offers except the last offer, of which the tenant requested, but did not receive, proof. The tenant sued for specific performance to purchase the property for $2.7 million based on the next-to-last offer the landlord received. The Appellate Division affirmed the order of the Supreme Court for New York County, which had granted the landlord's motion to dismiss the complaint and held that the law did not entitle the tenant to specific performance because the offer on which the tenant brought the lawsuit was not the last offer.[32] The appellate court stated that "[the tenant] was not entitled to select the offer it considered the most advantageous."[33] The court also stated the following about the tenant's last right of refusal:

> [T]he last right of refusal provided [the tenant] with an opportunity it would otherwise not have and that no other bidder enjoyed. It could beat any offer by 3% and the transaction could not close without affording [the tenant] that opportunity. If nothing else, the last right of refusal would serve as a disincentive to third-party bidding.[34]

The court, however, granted the tenant leave "to amend the complaint to plead . . . a cause of action for breach of the implied covenant of good faith and fair dealing with respect to the $3.09 million offer and for specific performance with respect to that offer."[35] In a vigorous dissent, Judge Gonzalez argued that the majority had rendered the landlord's statute-of-frauds argument moot (the majority declined to address this issue) and had rewritten the lease to grant the tenant a "different and novel right"; namely, the right to accept only the last offer and to "sue on a subsequent written offer it had never sought to enforce."[36]

C. Right of First Negotiation

To avoid the chilling effect of a right of first refusal the parties instead may use a right of first negotiation. The right of first negotiation provides that the owner must notify the right's holder that the owner intends to sell or lease the property. The parties then have a specified period of time to negotiate, on an exclusive basis, a mutually acceptable deal. The obvious ad-

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[32] *See id.* at 418, 420.

[33] *Id.* at 418.

[34] *Id.* at 419.

[35] *Id.* at 420.

[36] *Id.* (Gonzalez, J., dissenting).

vantage to the owner of a right of first negotiation over a first-refusal right is that the right of first negotiation period ends *before* the owner (or broker or other third party) invests time and money in negotiating a deal; therefore, no chill on the marketability of the asset results. A right of first negotiation does not give the right's holder any assurance that the parties will reach final agreement on the price and terms for the transaction. If the exclusive negotiation period lapses without an agreement on price and terms, the owner generally is free to sell or lease the property to a third party free and clear of the rights of the holder of the first-negotiation right.

D. Right of First Offer

In some transactions, particularly those involving the sale of real estate, the parties will provide for a right of first offer (RFO) in favor of the buyer.[37] The holder of an RFO has the first right to make an offer for the purchase of the property before the owner can sell the property to a third party. The owner then has a specific period to accept or reject the offer. If the owner rejects the offer, he is free to sell the asset to one or more third parties, with the only restriction being that he cannot accept a price less than (or in some cases less than a percentage of) the price offered by the holder of the RFO. This restriction puts the holder of the RFO in the position of naming its price without knowing the owner's estimate of the value and without the opportunity to require the owner to negotiate to an agreed price (unless that right is included in the agreement). The RFO is used, for example, when a purchaser of a parcel wants a right to buy adjacent parcels of land owned by the seller as they become available for sale, but the owner is unwilling to give an option or right of first refusal. Owners may prefer an RFO over a right of first refusal because an RFO minimizes the chilling effect on the marketability of the property. The holder of an RFO can also protect himself by requiring the owner to offer the property to him before the owner can offer the property to a third party. The offer should contain the terms (including price) that the owner will accept, as this requirement "smokes out" the price that the owner will accept. The owner still controls the timing of any potential sale, however, and is not obligated to reduce the price it asks for the property even if it is unreasonable.[38]

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[37] See Appendix C for a sample form that contains a right of first refusal and a right of first offer.

[38] However, the holder of the right may obligate the owner to sell the property for at least that price (or a certain percentage thereof) if the holder elects not to accept the owner's offer. *See generally* Paul S. Rutter & Duane M. Montgomery, Options, Rights of First Refusal, Rights of First Negotiation (1999), *available at* http://www.gilchristrutter.com/CM/

IV. CARVEOUTS FROM RIGHTS OF FIRST REFUSAL

Parties that grant and receive rights of first refusal should be careful to carve out from these rights any transactions they intend to exclude. Examples include transfers of property between a parent and a subsidiary corporation or other affiliated entities; foreclosures or deeds in lieu of foreclosure respecting the real property; stock transfers; transfers between co-owners or co-tenants; gifts and donations; sales of stock in a corporation that owns the property; transfers between individuals and a limited liability company or a partnership in which the individuals are the sole members or partners (as well as other forms of equity transfers with respect to other entities, such as trusts); involuntary takings of the property by government condemnation; transfers of interests between tenants in common; portfolio or bulk sales of multiple properties (including the property subject to any such right) in a single transaction; and tax-free exchanges under Internal Revenue Code (Code) section 1031. This Part will review the existing case law in this area and suggest strategies for eliminating (or at least minimizing) the problems that may occur.

A. Gifts and Donations

In *Park Station Ltd. Partnership v. Bosse*,[39] the Maryland Supreme Court held that absent clear language to the contrary in the parties' agreement, first-refusal rights do not apply to a donation of property to a charitable foundation and do not run with the land to bind the donee. The court stated that "courts have consistently held that a transfer of property by gift does not trigger a right of first refusal based upon a 'sale' or decision to 'sell.'"[40]

In *Schroeder v. Duenke*,[41] a case with unusual facts, the owners of the property sold and conveyed it to the purchasers pursuant to a warranty deed. Shortly thereafter, the parties separately executed a document granting the sellers the first right of refusal to repurchase the property upon certain terms and conditions.[42] Several years later, the purchasers conveyed the property to their son for less than the appraised value of the property without notify-

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Articles/Options,%20Rights%20of%20First%20Refusal.pdf; Gregory G. Gosfield, *A Primer on Real Estate Options*, 35 REAL PROP. PROB. & TR. J. 129, 163 (2000) (discussing features of right of first offer).

[39] 835 A.2d 646 (Md. 2003).

[40] *Id.* at 652.

[41] 265 S.W.3d 843 (Mo. Ct. App. 2008).

[42] *See id.* at 845.

ing the holders of the right of first refusal.[43] Although the Missouri Court of Appeals acknowledged that the transfer was not a gift (or akin to a gift) because the son paid $85,000 for the property and financed $60,000 of the price through a bank mortgage,[44] it denied summary judgment in favor of the holders of the right of first refusal and remanded the case for a determination of whether the son's offer was in fact a bona fide offer—that is, based on the fair market value of the property as established by the court's review of the evidence.[45] The court noted that "under Missouri law, a transfer of property by true gift [without any consideration] from one family member to another does not trigger a right of first refusal."[46]

B. Stock Transfers

In *LaRose Market, Inc. v. Sylvan Center, Inc.*,[47] the plaintiff-tenant (LaRose Market) leased space to operate a supermarket in a shopping center owned by the defendant-corporation (Sylvan Center). A provision in the lease provided LaRose Market with a right of first refusal to purchase the

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[43] *See id.* at 845–46.

[44] *See id.* at 847.

[45] *See id.* at 848–49.

[46] *Id.* at 847. For a more thorough discussion of *Schroeder*, see Harrison Ominsky, *Right of First Refusal – Impairing Family Gift*, 38 MD. REAL EST. L. REP. 3 (2009), and J. A. Bryant, Annotation, *Construction and Application of "First Refusal" Option Contained in Trust Instrument and Relating to Sale of Shares of Stock*, 51 A.L.R.3D 1327 (1973). *See also* Cottrell v. Beard, 9 S.W.3d 568, 571 (Ark. Ct. App. 2000) (holding that grantees' transfers of their interests as gifts for no consideration did not trigger right of first refusal and stating that "there is no evidence here that appellees were mere straw persons through whom title was to pass on to someone else for consideration"); Isaacson v. First Sec. Bank, 511 P.2d 269, 272 (Idaho 1973) (holding that a father's below market sale to his son was deemed a gift that did not trigger first refusal right); Rucker Props., L.L.C. v. Friday, 204 P.3d 671, 674–75 (Kan. Ct. App. 2009) (holding that gifting of interests in subject property by other owners of the property to lessor through quitclaim deeds did not trigger lessee's right of first refusal because right was only applicable if "the Lessors desire to sell the property," transfers were made in exchange for one dollar, and no third parties were involved in the quitclaim deeds); Mericle v. Wolf, 562 A.2d 364, 367–68 (Pa. 1989) (holding that transfer by gift was not a sale because a "sale contemplates a vendor and a buyer and the transfer involves payment or a promise to pay a certain price in money or its equivalent" and concluding that because the term *sold* should "be given its ordinary meaning, the appellees' transfer by way of a gift did not activate the refusal right").

The foregoing cases illustrate the desirability of clearly expressing the parties' intentions with respect to such transfers in the provisions providing for an option or related right in property.

[47] 530 N.W.2d 505 (Mich. Ct. App. 2005).

demised property.[48] Sylvan Center subsequently sold 100% of its corporate stock to a third party. LaRose Market then sought specific performance of its right of first refusal, claiming that the sale was a scheme to deprive LaRose Market of that right. The Michigan Court of Appeals found that the transfer of property did not trigger the right of first refusal:

> The principal issue presented is one of first impression in this state, requiring us to decide whether the sale of all of a corporate lessor's stock constitutes a "sale" of the corporation's real property triggering a lessee's right of first refusal to purchase the demised property. We agree with defendant and the overwhelming majority of courts of other jurisdictions that have addressed this issue, and conclude that it does not.[49]

The court made the following findings: (1) the sale of a corporate lessor's stock (even 100% of its stock), standing alone, does not involve a sale of the real estate as contemplated by the right of first refusal; (2) LaRose Market was in no worse position than it was before the sale of the stock because it still retained its right to purchase the property under the right of first refusal contained in the lease; (3) Sylvan Center's sale of all of its corporate stock to a third party resulted in a mere change of identity of Sylvan Center's corporate shareholders and did not change Sylvan Center's legal ownership of the property; and (4) LaRose market made no showing of bad faith or wrongdoing on the part of Sylvan Center and did not present any evidence of fraud or wrong by Sylvan Center that would justify equitable intervention.[50]

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[48] *See id.* at 507.

[49] *Id.*; *see also* K.C.S. Ltd. v. E. Main St. Land Dev. Corp., 388 A.2d 181, 182 (Md. Ct. Spec. App. 1998) (dismissing lawsuit to enjoin sale of all corporate owner's stock as violating plaintiff's right of first refusal because only stock was sold and not real estate); Prince v. Elm Inv. Co., 649 P.2d 820, 823 (Utah 1982) ("[F]or purposes of a right of first refusal, a 'sale' occurs upon the transfer (a) for value (b) of a significant interest in the subject property (c) to a stranger to the lease, (d) who thereby gains substantial control over the leased property.").

[50] *See LaRose Mkt.*, 530 N.W.2d at 508–09. The court acknowledged, however, that "where a sale of property occurs between an individual and a corporation, rather than a mere corporate stock transfer, equitable considerations such as the parties' motives for the sale and the relationship between the parties become relevant." *Id.* at 509.

C. Portfolio or Bulk Sales

The majority of courts hold that when an owner sells or attempts to sell property burdened by a right of first refusal as part of a larger package of properties, the right of first refusal is not activated in its traditional sense.[51]

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[51] *See, e.g.*, Aden v. Estate of Hathaway, 427 P.2d 333, 334 (Colo. 1967) (ruling that holder of right of first refusal is entitled to enjoin the sale of burdened parcel if owner decides to sell encumbered parcel as part of larger tract); Thomas & Son Transfer Line, Inc. v. Kenyon, Inc., 574 P.2d 107, 112 (Colo. App. 1977) ("[A]n owner of property cannot defeat a right of refusal simply by selling the optioned property with other properties which he may own. To deny specific performance here would be to defeat the entire purpose of the right of refusal, the protection of the lessee."), *aff'd*, 586 P.2d 39 (Colo. 1978); USA Cable v. World Wrestling Fed'n Entm't, Inc., No. Civ. A. 17983, 2000 WL 875682, at *15 (Del. Ch. Jun. 27, 2000) ("New York courts construing right of first refusal clauses have uniformly held that a property owner cannot compel the holder of a right of first refusal to one property to match the terms of a package deal encompassing extraneous properties."), *aff'd*, 766 A.2d 462 (Del. 2000); Stuart v. Stammen, 590 N.W.2d 224, 228 (N.D. 1999) (ruling that holder of right of first refusal could not be forced to purchase property in addition to that which was subject to such right); Radio Webs, Inc. v. Tele-Media Corp., 292 S.E.2d 712, 715–16 (Ga. 1982) (applying rule of law from lease cases that sale of parcel larger than the property for which a lessee held a right of first refusal was a breach of contract, finding that rule applied to sale of a business, and ordering trial court to enter temporary injunction in favor of radio company and take whatever steps were necessary to protect its potential right to relief); Whyhopen v. Via, 404 So. 2d 851, 853 (Fla. Dist. Ct. App. 1981) (explaining that landlord could not refuse to honor tenants' first refusal right on theory that tenants had not agreed to purchase entire parcel described in contract for sale); Gyurkey v. Babler, 651 P.2d 928, 933 (Idaho 1982) ("Even though vendor separately valued, as a part of total transaction, lot as to which plaintiff had right of first refusal, such lot could not be sold as part of larger parcel as long as lot was subject to such right of first refusal, because the door would be opened to a myriad of unscrupulous endeavors designed to defeat preemptive rights of purchase by manipulation of lot prices within the terms of a larger sale." (internal quotations marks omitted)); Myers v. Lovetinsky, 189 N.W.2d 571, 575 (Iowa 1971) ("This is a case in which landlords sell the whole farm including the demised premises to purchasers without separately pricing the demised premises and the rest of the farm. The decisions recognize in this kind of case, apparently without exception, that the landlord breaches the tenant's preferential right [of first refusal] by so doing."); Guaclides v. Kruse, 170 A.2d 488, 495 (N.J. Super. Ct. App. Div. 1961) ("We concur in the generally accepted view as to the optionee's right to an injunction to restrain a vitiating of its option by the inclusion, in the owner's prospective sale, of property in excess of that covered by the option. To allow the owner of the whole to by-pass the optionee merely by attaching additional land to the part under option would render nugatory a substantial right which the optionee had bargained for and obtained."); Tarallo v. Norstar Bank, 534 N.Y.S.2d 485, 487 (App. Div. 1988) (holding that lessees could not compel conveyance of entire parcel because right of first refusal did not extend to entire parcel); New Atlantic Garden v. Atlantic Garden Realty Corp., 194 N.Y.S. 34 (App. Div. 1922) (holding that lessee of movie theater with right of first refusal cannot be forced to match terms of third party's offer to buy from lessor a larger parcel including the theater), *aff'd*, 237 N.Y. 540 (1923); Boyd & Mahoney v. Chevron, U.S.A., 614 A.2d 1191, 1194 (Pa.

A minority of courts hold that the right of first refusal entitles its holder to specific performance (as opposed to injunctive relief) on the burdened property alone and that if the rightholder chooses not to exercise the right, then the owner can proceed with the sale of the larger package.[52] These courts generally have granted relief in the form of specific performance or

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Super. Ct. 1992) ("[A] right of first refusal as to the conveyance of a property cannot be defeated by including that property in a multi-property or multi-asset transaction. . . . The appellants' argument that the right can be nullified simply by packaging the property for sale with another asset not so encumbered has no merit. Appellants' logic would deprive the holder of the right the benefit of his or her bargain." (citation omitted)); Ollie v. Rainbolt, 669 P.2d 275, 280 (Okla. 1983) ("Because the owner breached the tenant's preferential right by attempting to sell the leased premises as part of the larger tract, the tenant can seek injunctive relief to maintain the status quo until the end of the lease term, when his preferential right will have expired."); Sawyer v. Firestone, 513 A.2d 36, 40 (R.I. 1986) ("[A] seller may not defeat a right of first refusal by selling the property subject to the right as part of a larger tract."); Brito v. Belvedere Developers, LLC, No. Civ. A. PC 03-6232, 2004 WL 877565, at *8 (R.I. Super. Ct. Mar. 29, 2004) ("Owners should not be permitted to attempt to sell their encumbered parcels to third parties by joining with other landowners, and then be able to deny the rightholder an opportunity to exercise his right by arguing that the encumbered parcel was part of a larger package."); Landa v. Century 21 Simmons & Co., 377 S.E.2d 416, 421 (Va. 1989) (holding that holder of right of first refusal cannot be compelled to purchase more than is subject to right of first refusal or else forfeit first refusal right); Rottier v. Walsh, No, 99-0078, 1999 WL 741476, at *3 (Wis. Ct. App. Sept. 23, 1999) (holding that unambiguous language of right of first refusal did not permit respondent to require rightholder to either purchase a portion of the parcel or abandon her right of first refusal on that portion); Raymond v. Steen, 882 P.2d 852, 857 (Wyo. 1994) ("[A] right of first refusal is not triggered by an offer on a larger tract which includes the burdened property. Neither is a right of first refusal satisfied by an offer to the holder of the right to sell him a larger tract."); Chapman v. Mut. Life Ins. Co. of N.Y., 800 P.2d 1147, 1151–52 (Wyo. 1990) (holding that while package deal did not trigger right of first refusal in the traditional sense that rightholder could purchase the property, the right entitled the holder to injunctive relief with respect to sale of burdened property and explaining that courts often will "return to the status quo ante and require a bona fide offer on the smaller tract before the right may be exercised or considered waived").

[52] *See* Berry-Iverson Co. of N.D., Inc. v. Johnson, 242 N.W.2d 126, 134 (N.D. 1976) (holding that attempted package sale activates right of first refusal, entitling rightholder to specific performance on burdened property alone). *See generally* Jean E. Maess, Annotation, *Option to Purchase Real Property as Affected by Optionor's Receipt of Offer for, or Sale of, Larger Tract Which Includes the Optioned Parcel*, 34 A.L.R.4TH 1217 (1984); Thomas J. Goger, Annotation, *Landlord and Tenant: What Amounts to "Sale" of Property for Purposes of Provision Giving Tenant Right of First Refusal if Landlord Desires to Sell*, 70 A.L.R.3D 203 (1976). Only one case appears to take the position that the failure to address the ramifications of a package deal abrogates any remedy for the rightholder. *See* Crow–Spieker #23 v. Robert L. Helms Constr. & Dev. Co., 731 P.2d 348, 350 (Nev. 1987).

monetary damages at a value set by the court or by the parties.[53] For example, in *Pantry Pride Enterprises, Inc. v. Stop & Shop Cos.*,[54] the U.S. Court of Appeals for the Fourth Circuit concluded that specific performance was the more appropriate remedy when the parties to the sale assigned separate valuations to the personalty and leasehold interests and thereby eliminated the problems commonly associated with awarding specific performance in such cases. The court stated the following:

> In the typical case, a landowner leases a portion of his property to a lessee, who secures a right of first refusal. The landowner subsequently agrees to sell the leased portion and some adjacent property to a third party for a single price. When the lessee tries to purchase only the leased portion of the package, the lessor tries to force the lessee into accepting the package deal or allowing the sale. Most courts resolve this conflict by enjoining the sale of any property subject to the lessee's option. Several practical problems arise in granting specific performance in these contiguous property cases. The first problem is one of valuation. If a court allows the lessee to buy only the leasehold portion, the court must allocate the single purchase price between the leased portion and the remainder of the lessor's property. Some courts are reluctant to undertake this process, which may require the court to determine the value of each acre offered for sale. The second problem is that specific performance may be inequitable for three reasons. First, if the lessor sold the leased and nonleased portions together, he would probably receive a greater price than if he sold the properties separately. By forcing the lessor to sell only the leased portion, the court may be depriving the lessor of this premium. Second, the remaining property may be difficult to sell without the attached leased portion. Third, specific performance forces the lessor to separate his contiguous property merely because he leased a portion of it to the

[53] *See* Brenner v. Duncan, 27 N.W.2d 320, 322 (Mich. 1947) (ruling that, with respect to attempted package sale including burdened property, "it is competent for the court to fix the option price, afford the optionee an opportunity to accept and thereupon specifically enforce the resulting contract").

[54] 806 F.2d 1227 (4th Cir. 1986).

> lessee. Because of these equitable considerations, most courts do not grant specific performance, but simply protect the lessee's option by enjoining the sale of the leased portion.[55]

If the language of the right of first refusal is vague as to the terms and conditions under which the rightholder may exercise the right (including the amount of property covered) or specifically covers more than one parcel, the rightholder might have to match an offer for the entire package or lose its right of first refusal.[56]

At least one court has held that, with respect to a package deal including the encumbered property, if the holder of the right of first refusal elects to exercise the right, the right entitles him to preemptive specific performance

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[55] *Id.* at 1229–30 (citations omitted); *see also In re* Adelphia Commc'ns Corp., 368 B.R. 348, 353 (Bankr. S.D.N.Y. 2007) ("Courts recognize a risk in package deals that the purchase price may be unfairly allocated or padded to defeat rights of first refusal."); Navasota Resources, L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 536, 543 (Tex. App. 2008) (allowing specific performance by holder of right of first refusal and stating that "[v]irtually every authority of which we are aware agrees that the holder of a preferential right cannot be compelled to purchase assets beyond those included within the scope of the agreement subject to the preferential right in order to exercise that right," but holding that the preferential right provision requires only that the holder match the third-party offer, not pay fair market value); *cf.* Hicks v. Castille, 313 S.W.3d 874, 883 (Tex. App. 2010) ("Although the Agreement does refer to 'the four-acre tract,' it does not specifically provide that the right of first refusal is limited to only the four-acre tract intact. The parties could have negotiated more specific terms but did not do so."); FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., 301 S.W.3d 787, 802 (Tex. App. 2009) (distinguishing *Navasota* and holding that the holder of the right of first refusal "was required to meet the terms and conditions of [the third party's] offer, including the conditions requiring acquisition of business assets, unless those conditions were not commercially reasonable, were imposed in bad faith, or were specifically designed to defeat [the right holder's] preferential right").

[56] *See* W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1564 (5th Cir. 1990) ("Most courts have insisted that [holders of rights of first refusal] replicate a myriad of nonprice conditions, including . . . the purchase of a larger quantity of land."); *In re* New Era Resorts, LLC, 238 B.R. 381, 387 (Bankr. E.D. Tenn. 1999) (holding that when parties did not specify that the owner must market alone the tract subject to the right of first refusal, and when holder of right rejected offer to purchase subject parcel together with other property and offered only to purchase subject parcel, right of first refusal lapsed and rightholder's offer constituted rejection and counter-offer, which debtor was free to and did reject); *see also* FRIEDMAN, *supra* note 25, § 15:6.2 ("[The] right of first refusal may be fatally defective if it should be impossible to determine the description of the premises."). *But see* USA Cable v. World Wrestling Fed'n Entm't, Inc., No. Civ. A. 17983, 2000 WL 875682, at *16 (Del. Ch. Jun. 27, 2000) (distinguishing *West Texas Transmission* and stating that "*In re New Era Resorts* does not represent New York law on this subject").

on the entire package. In *Capalongo v. Giles*,[57] a New York trial court ruled that:

> [W]here an owner does have an offer from a third party to purchase a piece on which he has given a first refusal option, but on terms which specify inclusion of the piece in a larger parcel . . . he thereupon has a duty to offer the whole parcel to the option holder on the same terms.[58]

The appellate court reversed this decision on the issue of the adequacy of the consideration for the right of first refusal.[59] The appellate court found that failure to give adequate consideration made the option agreement revocable. The owners of the property also contended that the option was in fact revoked by the rightholders because the owners had advised the rightholders they would not sell the triangular parcel (which was subject to the right of first refusal) separately from the remaining 123 acres. According to the owners, the rightholders stated that they were not interested in purchasing the larger tract. The owners also claimed that execution of the third-party contract for the entire 123 acres "constituted a revocation of the option since such action was patently inconsistent with the terms of the option."[60] The court agreed, finding that "[t]he option, which failed to recite either its duration or that it was irrevocable, was effectively revoked by the subsequent actions of the [owners]" and that the trial court "erred in concluding that the option required the [owners] to give [the rightholders] a first refusal on the [entire] 123-acre tract."[61]

In *Thompson v. Herold*,[62] the California Court of Appeal ruled on whether a proposed sale to a third party of property that consists of more than the property subject to a right of first refusal obligates the owner to accept from the right's holder an offer to purchase only the specific property

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[57] 425 N.Y.S.2d 225 (Sup. Ct. 1980), *rev'd sub nom.* Capalongo v. Desch, 438 N.Y.S.2d 638 (App. Div. 1981), *aff'd*, 453 N.Y.S.2d 243 (1982) (mem.).

[58] *Id.* at 228.

[59] *See* Capalongo v. Desch, 438 N.Y.S.2d 638, 640.

[60] *Id.*

[61] *Id.*; *see also* Qualtronics Mfg., Inc. v. Levinson, No. 93-17018, 1995 WL 217044, at *1 (9th Cir. Apr. 10, 1995) (affirming judgment in favor of lessee that it had not filed a groundless lis pendens notice against lessor's property when lease was silent as to whether right of first refusal extended to allow lessee to match an offer for entire business park, and finding that district court properly concluded that tenant had a rational argument that its right of first refusal extended to an offer to purchase other buildings along with its leasehold).

[62] No. 8167819, 2004 WL 1387849 (Cal. Ct. App., Jun. 22, 2004).

subject to the right. In this case, a dentist leased the first floor of a two-story building. The lease gave the tenant the right to buy the building for its appraised value ($590,000) if the landlord chose to sell the leased premises.[63] If the tenant did not exercise the right, the lease would remain in effect and the landlord subsequently could offer it for sale to a third party, but the tenant would have a right of first refusal that he could exercise by giving written notice of acceptance within forty-five days.

The landlord subsequently offered the leased premises, plus the adjacent building that it also owned, to the tenant for a net price of $1,165,000. The tenant counter offered, proposing to purchase only the building he occupied for $590,000 and imposing additional conditions.[64] The landlord did not accept the counteroffer and placed both properties on the market the day after the tenant's counteroffer expired.[65] The landlord then accepted an offer of $1,135,000 for both buildings from a third party. To obtain more favorable financing, the third party issued a separate written offer for each property with $790,000 allocated to the building occupied by the tenant and $525,000 for the adjacent building. The landlord then offered the tenant the opportunity to match the $790,000 offer for the building the tenant occupied, but the tenant insisted that the landlord allow him to purchase the building for $590,000.

The California appellate court ruled that the tenant's right to purchase the building it occupied for its appraised value was never triggered, so the owner was not obligated to accept the tenant's $590,000 offer.[66] The court reasoned that to trigger the tenant's right the owner had to offer to sell the tenant only the building occupied by the tenant.[67] Because the landlord offered two buildings to the tenant, the court ruled that the tenant's right was never triggered:

> [The tenant's] preemptive right has not yet arisen because [the landlord] listed the buildings as a package, rather than as individual properties. This failed to trigger [the tenant's] preemptive right to purchase a single building, as required under the . . . lease. . . . [The landlord] ha[s] failed to present [the tenant] with an offer that

[63] *See id.* at *1.
[64] *See id.* at *1–2.
[65] *See id.* at *2.
[66] *See id.* at *5.
[67] *See id.*

> specifies the purchase price of [the building occupied by the tenant] as a single building.[68]

Interestingly, the court prefaced its holding by discussing the differences between an option and a preemptive purchase right:

> At the outset, we must distinguish between an option contract and a preemptive purchase right because the parties use the terms interchangeably. The important distinction is that only an option contract may be specifically enforced. A preemptive right is not subject to specific performance because it is not a contract.
>
> An irrevocable option is a contract made for consideration, to keep an offer open for a prescribed period. It is a unilateral contract . . . and is binding on both parties. If the seller refuses to perform, the contract may become the subject of a suit for specific performance. The decision to exercise an option rests with the prospective purchaser.
>
> By contrast, a preemptive purchase right is dependent upon the owner's decision to sell his property. A preemptive right gives the grantee the first opportunity to purchase property *if* the owner chooses to sell. If the owner elects not to sell, the buyer cannot compel a sale. For this reasons [sic], a preemptive purchase right is not a contract and may not be specifically enforced.[69]

Generally, courts will strictly construe rights of first refusal and resolve ambiguities in favor of the grantor of the right, whether in connection with package sales or other issues concerning rights of first refusal.[70] The contractual language generally controls, unless it is ambiguous.[71]

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[68] *Id.*

[69] *Id.* at *3–4 (citations and internal quotation marks omitted).

[70] *See, e.g.*, Creque v. Texaco Antilles Ltd., 409 F.3d 150, 151–55 (3d Cir. 2005) (holding that transfer of assets and liabilities by owner of property in connection with corporate restructuring, where conveyance was between two subsidiary corporations each owned by same parent, was not equivalent of "bona fide offer to purchase" sufficient to trigger right of first refusal with respect to real property).

[71] *See, e.g.*, Crestview Builders, Inc. v. Noggle Family Ltd. P'ship, 316 N.E.2d 1132, 1136–37 (Ill. App. Ct. 2004) (holding that right of first refusal was vague, and therefore unenforceable, because it did not contain a price term and did not specifically state that the price would be set by competing offer); Uno Restaurants, Inc. v. Boston Kenmore Realty

D. Foreclosures or Deeds in Lieu of Foreclosure

The language respecting whether a foreclosure (or a deed in lieu of foreclosure) triggers a right of first refusal should be clear and unambiguous. Foreclosures and deeds in lieu should be specifically exempted unless the parties expressly agree to the contrary. Otherwise, interpretation of the provision will depend on the specific language in the clause and the particular jurisdiction in which the parties litigate the issue. Although a foreclosure or other involuntary sale of property generally is not an event within the contemplation of the parties with respect to a right of first refusal, the language in the clause must be examined carefully.[72]

For example in *Pelladini v. Valadao*,[73] the California Court of Appeal ruled that, where two sisters owned real property as tenants in common, the fact that one of the sisters gave the other a deed in lieu of foreclosure on her undivided one-half interest in the property (as satisfaction of a note and

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Corp., 803 N.E.2d 957, 965–67 (Mass. 2004) (holding that bona fide offer to landlord existed when landlord received legitimate noncollusive offer to purchase property from third party, even if that offer was higher than market value, and that landlord did not violate covenant of good faith and fair dealing because lease did not require any particular action by landlord to protect tenant's right of first refusal); J & J Celcom v. AT&T Wireless Servs., Inc., No. C03-2629P, 2005 WL 1126924, at *8–9 (W.D. Wash. May 10, 2005) ("[N]othing in any of the partnership agreements limited to whom the partnership assets could be sold. If the parties intended to limit the sale to non-affiliated entities, they could have done so in the agreements. The language regarding sales is unambiguous."). *See generally* C. R. McCorkle, Annotation, *Grant to Lessee of First Privilege or Right to Purchase Leased Premises as Constituting Absolute or Conditional Option*, 34 A.L.R.2D 1158 (Supp. 2011); Bernard Daskal, *Rights of First Refusal and the Package Deal*, 22 FORDHAM URB. L.J. 461 (1995); Sara Church Dinkler & Morgan R. Smock, *Toss That Form Book: How to Draft an Effective Right of First Refusal Clause*, AM. CORP. COUNS. ASS'N DOCKET, Jul./Aug. 1998, at 50, 59; Harris Ominsky, *Real Estate Options: Using Them and Losing Them (Part 1)*, PRAC. REAL EST. LAW., Nov. 1999, at 55, 65.

[72] The language contained in the right-of-first-refusal provision usually is controlling. *See* Cities Serv. Oil Co. v. Estes, 155 S.E.2d 59, 64 (Va. 1967) (ruling that an involuntary transfer of the leased premises by public foreclosure sale activates the lessee's right of first refusal contained in the lease because lease provision giving tenant right of first refusal to purchase did not indicate intention to exclude judicial sales); *cf.* CIT Group Equip. Fin., Inc. v. Alberto, 130 F.R.D. 657 (N.D. Ill. 1990) (holding that involuntary transfer of property pursuant to court order was not arms-length bona fide offer and that tenant could intervene as matter of right in supplemental proceeding that resolved disputes among debtor-landlord's judgment creditors and permitted one creditor to transfer property so that it was not subject to tenant's rights of first refusal); Draper v. Gochman, 400 S.W.2d 545, 547 (Tex. 1966) (holding that words "desires to sell" in clause granting tenant first right of refusal to purchase property did not include an involuntary sale such as foreclosure of mortgage on the property, so that right of first refusal survived foreclosure sale).

[73] 7 Cal. Rptr. 3d 413 (2003).

deed of trust on her interest in the property obtained from the other sister) did not trigger a right of first refusal.[74] The court found that the agreement containing the right of first refusal referred to the tenants in common in the conjunctive and to the property in the singular with no mention of the property other than as a whole. Thus, the court held that parties intended that the sale of the cotenants' combined interest to a third party would trigger the phrase *bona fide offer for purchase*.[75] The court found that "[t]here was no sale to a third party in this case."[76]

E. Condemnation Proceedings

Under certain circumstances, a court could find that a governmental condemnation proceeding triggers a right of first refusal. For example, in *Montara Water & Sanitary District v. County of San Mateo*,[77] the District Court for the Northern District of California held that, based on the language in the document as well as other factors (including the applicability of federal law), a condemnation proceeding triggered the right of first refusal. The court distinguished an earlier California appellate case that held an involuntary condemnation did not trigger the right of first refusal, finding in that case that the instrument itself resolved the issue of whether an involuntary disposition could trigger the right in question.[78]

While acknowledging that courts generally disfavor reversion clauses and strictly interpret them to prevent their exercise, the court also stated that "[i]n contrast to the 'use'—or 'sale'—based restrictions at issue in the foregoing cases, the airport deed's use of the word transfer does potentially

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[74] *See id.* at 418.

[75] *See id.*

[76] *Id.* Also see P.G. Guthrie, Annotation, *Rights of Holder of "First Refusal" Option on Real Property in Event of Sale at Foreclosure or Other Involuntary Sale*, 17 A.L.R.3D 962 (1968), which is an excellent source for other pertinent case law on this topic and is the only source the author is aware of that collects and discusses the cases on this topic (of which there are relatively few). *American Law Reports* regularly updates the piece. In section 2, entitled *Option as Conferring No Rights*, the annotation concludes with the majority viewpoint: "Most of the few authorities considering the question take the view that a foreclosure or similar involuntary sale is not within the contemplation of a 'first refusal' option and that the holder of the option therefore has no greater rights at such sale than any other buyer." But section 3 of the annotation also points out that contrary (though mostly older) cases exist. "Some courts have taken the view that the rights of the holder of a 'first refusal' option are not affected by the fact that the property is eventually sold involuntarily at a foreclosure or other forced sale."

[77] 598 F. Supp. 2d 1070 (N.D. Cal. 2009).

[78] *See* Campbell v. Ager, 83 Cal. Rptr. 2d 696, 697 (Ct. App. 1999).

broaden the scope of the grant restriction and weaken the inference that a disposition must be voluntary to constitute a breach."[79]

F. Transfers of Individual Interests to LLCs

In *Evans v. SC Southfield Twelve Associates, LLC*,[80] a case involving the transfer of individual interests to an LLC, the United States Court of Appeals for the Sixth Circuit noted that "Michigan courts have held that a contract provision containing a right of first refusal must be interpreted narrowly."[81] The court ruled that the property owners' intention to transfer, for no monetary consideration, their interest in commercial property to an LLC—of which they were the sole owners and in which they had membership interests in the same proportion to their existing property ownership interests—did not constitute a "desire to sell" in response to "a bona fide written offer" to purchase the property and did not trigger the tenant's first right of refusal under the lease.[82] The court reasoned that such a right would only apply if the landlord, as the property owners' successor-in-interest, desired to sell the property and received a bona fide written offer to purchase it.[83] The court found that valuable consideration did not support the transfer; the LLC gave no written offer of purchase; and the motive for transfer was not to deprive the tenant of its right of first refusal.[84] The court further ruled that even if the transfer to the LLC constituted a bona fide written offer, the transfer was contractually exempt from the right of first refusal because the lease stated that the right did not apply if the landlord sold or transferred the property to any of its officers, directors, or principal shareholders, or to any corporations or other entities in which the landlord had any substantial interest.[85] The court stated that "it is beyond dispute that the proposed transfer of interest from the Evans to [the new LLC] was not

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[79] *Montara Water & Sanitary Dist.*, 598 F. Supp. 2d at 1080; *see also* Benefit Realty Corp. v. City of Carrollton, 141 S.W.3d 346, 349–51 (Tex. App. 2004) (holding that church's conveyance of strip of land for widening and reconstruction of street was involuntary where city did not initiate condemnation proceedings but instead passed resolution authorizing it to acquire all parcels of land necessary to make public improvements to street, and therefore real estate corporation's loss of its right of first refusal as result of city's acquisition did not constitute a taking since right applied only to voluntary sale of property).

[80] No. 05-1679, 2006 WL 3724132 (6th Cir. Dec. 15, 2006).

[81] *Id.* at *3.

[82] *Id.* at *3, 5.

[83] *See id.* at *3.

[84] *See id.* at *4–5.

[85] *See id.* at *5–6.

the result of arms' length dealing and would not result in any real change in control of the property."[86]

The court cited several cases from other jurisdictions (Michigan never having specifically addressed the issue) that held "that the transfer of interest from individual owners to another entity controlled by those same individuals does not constitute a 'sale' that triggers a right of first refusal."[87]

Evans highlights the importance of clear and concise drafting of the first right of refusal—the tenant claimed that it should be able to purchase the real property for nothing, thereby matching the consideration paid by the existing owners for transferring the property to the LLC.[88]

G. Transfers of Partnership Interests to Individuals

Courts have generally held that transfers of partnership interests to individuals are outside the scope of an option or right of first refusal provision. For example, in *Hartzheim v. Valley Land & Cattle Co.*,[89] the California Court of Appeal held that the lessor, a family-owned partnership, did not trigger the lessee's right of first refusal on the sale of the real property contained in the lease when it transferred the property to the partners' grandchildren. The right did not trigger because the transfer was not made pursuant to a bona fide offer for the purchase of the property from a third

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[86] *Id.* at *4.

[87] *Id.*

[88] In *Gebhardt Family Investment, L.L.C. v. Nations Title Insurance Co. of New York*, 752 A.2d 1222 (Md. Ct. Spec. App. 2000), however, the Maryland Court of Special Appeals held that a transfer of land from two family members to an LLC, of which they were the only members, terminated coverage under a title insurance policy naming the individual family members as the insured parties. The Gebhardts argued that they nonetheless remained insured parties under the title policy because the conveyance was, in effect, to themselves, and therefore they still retained an interest in the property. *See id.* at 1225. However, the court noted the following:

> In contrast to a partnership, a limited liability company in Virginia is an entity separate from its members and, thus, the transfer of property from a member to the limited liability company is more than a change in the form of ownership; it is a transfer from one entity or person to another.

Id. (quoting Hagan v. Adams Prop. Assoc., Inc., 482 S.E.2d 805, 807 (Va. 1997) (internal quotation marks omitted)). The court held that while the Gebhardts had a personal property interest in the LLC, they no longer had an interest in the real property because they had conveyed it to the LLC. The court also rejected the Gebhardts' claim that no real conveyance occurred because the LLC in fact paid no consideration and ruled that the conveyance to the LLC provided the Gebhardts with actual and substantial benefits, "including limited liability and estate planning benefits." *Id.*

[89] 62 Cal. Rptr. 3d 815 (Ct. App. 2007).

party (the grandchildren were contingent beneficiaries under the partnership agreement) in an arms' length transaction and was for legitimate income tax and estate planning purposes.[90] The court stated that "it is the concurrence of both an arms' length transaction and change in control of the property that characterizes a bona fide sale."[91]

In *Bill Signs Trucking, LLC v. Signs Family Ltd. Partnership*,[92] the California Court of Appeal affirmed the trial court's ruling that a commercial lease's "preemptive purchase right" provision, which allowed the tenant the right of first refusal if the landlord received an acceptable offer from "any person," referred only to third persons.[93] The court held that a transfer between the partners in a family limited partnership that owned the property did not trigger the right of first refusal and that extrinsic evidence showed the original owner's strong interest in keeping the property in the family.[94] The court further determined that the transfer between the partners had no effect on the tenant's rights under the lease or its preemptive rights against third-party purchasers.[95]

V. AGREEMENTS CONTAINING BOTH AN OPTION TO PURCHASE AND A RIGHT OF FIRST REFUSAL

Tenants (and landlords) can get themselves into trouble when, as occasionally happens and as noted earlier in this article, the lease provides the tenant with both a fixed-price option and a right of first refusal.

For example, in *Markert v. Williams*,[96] the issue before the court (which was a matter of first impression) was "whether the [tenant's] fixed-price option was extinguished by his failure to exercise his right of first refusal, followed by the subsequent sale of the property to a bona fide purchaser."[97] In 1973, the tenant entered into a lease with the owners of the property.[98] The lease provided the tenant with an option to purchase the property and a right of first refusal in the event that a third party offered to purchase the property. Two years later, the tenant sublet the property to Markert, the

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[90] *See id.* at 824.
[91] *Id.* at 823.
[92] 69 Cal. Rptr. 3d 589 (Ct. App. 2007).
[93] *Id.* at 597.
[94] *See id.* at 594–97.
[95] *See id.* at 594.
[96] 874 S.W.2d 353 (Tex. App. 1994).
[97] *Id.* at 356.
[98] *See id.* at 354.

plaintiff. The owners received an offer from a third party to purchase the property in 1985, which they communicated to the tenant.[99] The tenant chose not to exercise either its option or its right of first refusal, and the property was sold to the third party.[100] In 1987, the tenant assigned all interest in its lease to Markert, including the tenant's interest in the option and right of first refusal. Markert attempted to exercise the option, but the new owners refused to convey the property. The court held that the tenant's fixed-price option terminated when the tenant failed to exercise the option before the landlord sold the property to a bona fide purchaser.[101]

Some courts have held that when both a right of first refusal and a fixed-price option are contained in the same agreement, the option right becomes ineffective and unenforceable when the holder of the right fails or refuses to exercise the right of first refusal after being presented with a bona fide third-party offer. For example, in *Shepherd v. Davis*,[102] the lessee, under the lease agreement, had both a fixed-price option to purchase a tract of real estate and a right of first refusal concerning the property. The Virginia Supreme Court ruled that the lessee forfeited his right to purchase the property under the fixed-price option after he became aware of a third-party offer.[103] The court did not permit the lessee to invoke the fixed-price option after failing to exercise the right of first refusal because the terms of the third-party offer, including a higher purchase price, were not acceptable to him.[104]

The court noted a split of authority as to whether (1) "a lessee may exercise a fixed-price option without regard to a right of first refusal," or (2) "a lessee forfeits the right to purchase under a fixed-price option . . . after being presented with a third-party offer."[105] The court reasoned that the result depends on the particular language used in the provision and found that "the terms of the dual-option provisions [are] clear and unambiguous."[106] The court interpreted the prefatory language to the grant of the right of first refusal—"[n]otwithstanding anything contained in this Agreement to the

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[99] *See id.* at 354–55.

[100] *See id.* at 355.

[101] *See id.* at 358. A possible way to avoid the issue raised in *Markert* would be to have the provision state specifically that notice by the owner of its intention to market the property would trigger the tenant's fixed-price option.

[102] 574 S.E.2d 514 (Va. 2003).

[103] *See id.* at 520–21.

[104] *See id.* at 517.

[105] *Id.* at 520.

[106] *Id.*

contrary,"[107] which did not appear in the portion of the lease provision referring to the option to purchase—as modifying the fixed-price option and giving precedence to the first right of refusal.[108] The court also noted that a sentence in the lease provided that if the landlord did not sell the leased premises in accordance with a third-party offer to purchase, the tenant's right of first refusal remained in effect, but that no similar statement continued the effectiveness of the fixed-price option under the same circumstances.[109]

Other cases, however, hold that the two provisions, unless otherwise provided in the agreement, are separate and distinct, and the tenant can exercise its fixed-price purchase option notwithstanding its failure to exercise its rights under the right of first refusal. These cases either find no ambiguities or involve provisions that explicitly state that the tenant's failure to exercise its right of first refusal shall not affect its fixed-price option (a good drafting tip).[110]

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[107] *Id.* at 517.

[108] *See id.* at 520.

[109] *See id.*; *see also* Shell Oil Co. v. Blumberg, 154 F.2d 251, 252–53 (5th Cir. 1946); Smith v. Bertram, 603 N.W.2d 568, 571–72 (Iowa 1999) (holding that if contract contained both option to purchase and right of first refusal and parties' intent was unclear, court would admit extrinsic evidence to determine whether the parties intended that the third-party offer would terminate the fixed-option right); Nw. Racing Ass'n v. Hunt, 156 N.E.2d 285, 288 (Ill. App. Ct. 1959); Tarrant v. Self, 387 N.E.2d 1349, 1353 (Ind. Ct. App. 1979); M & M Oil Co. v. Finch, 640 P.2d 317, 321 (Kan. Ct. App. 1982); Moon v. Haeussler, 545 N.Y.S.2d 623, 624–25 (App. Div. 1989); Tantleff v. Truscelli, 493 N.Y.S.2d 979, 983–84 (App. Div. 1985); Elec. Reliability Council of Tex., Inc. v. Met Ctr. Partners-4, Ltd., No. 03-04-00109-CV, 2005 WL 2312710, at *11 (Tex. App. 2005); *cf.* Four Howards, Ltd. v. J & F Wenz Rd. Inv., L.L.C., 902 N.E.2d 63, 72 (Ohio Ct. App. 2008) (holding that tenant's right of first refusal survived despite the fact that tenant's option to purchase property was subordinated to option right of third party because tenant's option to purchase and right of first refusal were separate contract rights under terms of business lease and first right of refusal became effective upon the expiration of tenant's option to purchase).

[110] *See* Gulf Oil Co. v. Chiodo, 804 F.2d 284, 286 (4th Cir. 1986); Shell Oil Co. v. Prescott, 398 F.2d 592, 593–94 (6th Cir. 1968); McDonald's Corp. v. Lebow Realty Trust, 710 F. Supp. 385, 388 (D. Mass.), *aff'd*, 888 F.2d 912 (1st Cir. 1989); Texaco, Inc. v. Creel, 292 S.E.2d 130, 133–34 (N.C. Ct. App. 1982); Amoco Oil Co. v. Snyder, 478 A.2d 795, 798 (Pa. 1984); Butler v. Richardson, 60 A.2d 718, 722 (R.I. 1948); Crawley v. Texaco, Inc., 306 N.W.2d 871, 873–75 (S.D. 1981). *See generally* Wanda Ellen Wakefield, Annotation, *Construction and Effect of Options to Purchase at Specified Price and at Price Offered by a Third Person, Included in Same Instrument*, 22 A.L.R.4TH 1283 (1983); FRIEDMAN, *supra* note 25, § 15:6.6 (discussing cases involving leases that contain dual options, i.e., both an option to purchase and a first option or right of refusal).

VI. APPLICABILITY OF THE RULE AGAINST PERPETUITIES

The rule against perpetuities, which provides that an interest is void for remoteness if by any possibility an interest cannot vest or fail within the twenty-one-year limit after some life in being at the creation of the interest, may also be at issue regarding options and related rights.[111]

Traditionally, the rule against perpetuities sought to prohibit remote vesting—that is, an owner's right to control title of property indefinitely. The underlying objective of the rule is to protect the alienability of property.[112] Options to purchase and related rights are generally subject to the rule against perpetuities. For example, the New York Court of Appeals, in *Symphony Space, Inc. v. Pergola Properties, Inc.*, stated that "[u]nder the common law, options to purchase land are subject to the rule against remote vesting."[113]

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[111] *See, e.g.*, N.Y. EST. POWERS & TRUSTS LAW § 9-1.1(b) (McKinney 2002) ("No estate in property shall be valid unless it must vest, if at all, not later than twenty-one years after one or more lives in being at the creation of the estate and any period of gestation involved.").

[112] *See, e.g.*, Symphony Space, Inc. v. Pergola Props. Inc., 646 N.Y.S.2d 641, 645 (1996) (noting that, both in their early and modern forms, rules restricting future dispositions of property were founded on the "principle that it is socially undesirable for property to be inalienable for an unreasonable period of time").

[113] *Id.* at 646; *see also* Emerson v. Campbell, 84 A.2d 148, 153 (Del. Ch. 1951) ("Options are regarded as having the effect of creating a future interest, depending upon the contingency of the exercise of the option. If it is possible that the option might not be exercised within the limits of the time allowed by the Rule Against Perpetuities, the option is void."). *But see Symphony Space*, 646 N.Y.S.2d at 648 ("Generally, an option to purchase land that originates in one of the lease provisions, is not exercisable after lease expiration, and is incapable of separation from the lease is valid even though the holder's interest may vest beyond the perpetuities period."). Other courts have made a similar exception to the rule against perpetuities. *See, e.g.*, Arclar Co. v. Gates, 17 F. Supp. 2d 818, 822–23 (S.D. Ill. 1998) ("[T]he right to purchase surface rights is not subject to the rule against perpetuities when the owner of the right requires the surface in order to remove minerals already owned. . . . Courts have held that an option to purchase land is valid as part of a long-term lease of that land."); Warren v. Albrecht, 571 N.E.2d 1179, 1180 (Ill. App. Ct. 1991) ("Interests subject to the rule [against perpetuities] are contingent remainders, executory interests (or devises), options to purchase land not incident to a lease for years, and powers of appointment."); III Lounge, Inc. v. Gaines, 348 N.W.2d 903, 907 (Neb. 1984) (holding that, absent words of express limitation, option to purchase leased property at any time during term of lease was exempt from rule against perpetuities and that because lease was extended upon same terms and conditions as original lease, option to purchase contained in original lease was extended for additional term of lease); El Paso Prod. Co. v. PWG P'ship, 866 P.2d 311, 317–18 (N.M. 1993) (holding that option to purchase leased premises was exempt from rule against perpetuities because court could "infer a reasonable time limit in the agreement"); Citgo Petroleum Corp. v. Hopper, 429 S.E.2d 6, 7–8 (Va. 1993) (holding

Although commentators have proposed that states exempt commercial transactions from the rule against perpetuities, in *Symphony Space*, New York's highest court held that the rule against perpetuities applies to both commercial and noncommercial options.[114] If an option to purchase does not comply with the rule against perpetuities, a court could hold that the interest is invalid because the right could be exercised (that is, become vested) at a time remote to the right's acquisition—especially if, for example, an option to purchase granted the holder an unlimited right to buy the owner's land at any time. Courts have ruled similarly with respect to rights of first refusal.[115]

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that rule against perpetuities does not apply to "an option to purchase that is attendant to a long-term commercial lease and exercisable during the term of the lease").

In *Arclar Co. v. Gates*, the court stated that "[i]t is true that a bare option to purchase or sell real estate exercisable outside the period of the rule against perpetuities is generally held to be void as an unreasonable restraint upon alienation." *Arclar Co.*, 17 F. Supp. 2d at 823. The court noted that the only exceptions to the rule were (1) an option to purchase land that is part of a long-term lease of that land, and (2) an option to purchase an overlying surface estate provided that the option was granted for the purpose of mining the mineral estate. *See id. But see* First Huntington Bank v. Gideon-Broh Realty Co., 79 S.E.2d 675, 685 (W.Va. 1953) ("There is . . . no difference in principle between an option in a lease that permits or may permit the remote vesting of title to real property and an option contained in any other document which would produce the same result."). *See generally* William Berg, Jr., *Long-Term Options and the Rule Against Perpetuities,* 37 CAL. L. REV. 419 (1949); W. Barton Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 660 (1938); George T. Dunlap III & Frederic G. Levin, Note, *Options and the Rule Against Perpetuities*, 13 U. FLA. L. REV. 214 (1960); Richard E. Macey, Comment, *Rule Against Perpetuities: Interests Subject to the Rule: Option Contracts: Preemptive Rights*, 28 CORNELL L.Q. 121 (1942); Annotation, *Independent Option to Purchase Real Estate as Violating Rule Against Perpetuities or Restraints on Alienation*, 66 A.L.R.3D 1294 (1975); 49 AM. JUR. 2D, *Landlord and Tenant* § 159 (2006); 61 AM. JUR. 2D, *Perpetuities and Restraints on Alienation* § 6 (2002) (stating that property interests tend to restrain the free alienability of property and interfere with its beneficial use); 61 AM. JUR. 2D, *Perpetuities and Restraints on Alienation* § 61 (2002) ("Options for renewal in leases are generally held to be valid even though the covenant may be for perpetual renewal."); 3 L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS § 1244 (3d ed.) (discussing rule against perpetuities with respect to option rights and examining applicable case law); FRIEDMAN, *supra* note 25, § 15:6.2 ("A right of refusal in a lease does not violate the Rule Against Perpetuities, at least in commercial transactions. Where the right of first refusal is in gross, that is, not connected with the lease, the cases are divided on whether the Rule Against Perpetuities is applicable.").

[114] *See Symphony Space*, 646 N.Y.S.2d at 646.

[115] *See, e.g.*, Ferrero Constr. Co. v. Dennis Rourke Corp., 536 A.2d 1137, 1144 (Md. 1988) (holding that rule against perpetuities is implicated by right of first refusal to purchase real estate because lawmakers designed the rule not only to facilitate the alienability of property but also to prevent restrictions that render title to land uncertain); Webb v. Reames, 485 S.E.2d 384, 385 (S.C. Ct. App. 1997) (invalidating right of first refusal in deed where contingent, nonvested interest attempted to reserve to holder of preemptive right, i.e. the

As noted above, a majority of jurisdictions, finding that options and rights of first refusal are interests in property and not mere contract rights, recognize that these interests are subject to the rule against perpetuities. For example, the Delaware Supreme Court stated the scope of the rule's application:

> Although the rule is most often applied in the construction of testamentary devices, it applies equally to rights of first refusal, also known as preemptive rights, to acquire interests in land. Despite the view of some courts that preemptive rights are merely contract rights and not direct interests in property, a vast majority of courts and commentators view such rights as equitable claims sufficient to support an action for specific performance if the property owner attempts to sell to someone other than the owner of the right of first refusal. Because the holder of the right of first refusal acquires merely an equitable interest, it remains inchoate until the owner decides to sell thus triggering the right of first refusal.[116]

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grantor, a perpetual option to repurchase the property for the original consideration); *cf. In re* Cont'l Cablevision, Inc. v. United Broad. Co., 873 F.2d 717, 722 (4th Cir. 1989) ("Of all options, a right of first refusal is one of the least obnoxious to the policy concerns of the rule."); *In re* Wauka, Inc., 39 B.R. 734, 737 (Bankr. N.D. Ga. 1984) (holding that because right of first refusal included in sales contract and warranty deed was personal to individual holder of the right, it did not violate rule against perpetuities and holder would be permitted to exercise that right); Selig v. State Highway Admin., 861 A.2d 710, 724–26 (Md. 2004) (holding that rule against perpetuities does not apply to right of first refusal in contract and deed where state statute mandates applicable language); Park Station Ltd. P'ship v. Bosse, 835 A.2d 646, 656 (Md. 2003) (ruling that contract or other instrument, including right of first refusal, "should be interpreted if feasible to avoid the conclusion that it violates the Rule Against Perpetuities"). *See generally* Jonathon F. Mitchell, *Can A Right of First Refusal Be Assigned?*, 68 U. CHI. L. REV. 985, 994 (2001) ("In traditional common law jurisdictions, a right of first refusal of indefinite duration violates the common law Rule Against Perpetuities.").

[116] Stuart Kingston, Inc. v. Robinson, 596 A.2d 1378, 1384 (Del. 1991); *see also* Atchison v. City of Englewood, 463 P.2d 297, 301 (Colo. 1970) (en banc) (holding that a provision in an agreement for the sale of a parcel of real property which prohibits the grantee from selling the parcel unless he first offers it to the grantor is valid, unless it violates the common law rule against perpetuities); Fallschase Dev. Corp. v. Blakey, 696 So. 2d 833, 836–37 (Fla. Dist. Ct. App. 1997) ("[T]he first refusal right here at issue was void *ab initio* because it violates the common-law rule against perpetuities."); *Park Station*, 835 A.2d at 653–54 (citation omitted) ("[T]he [r]ule [against perpetuities] applies to an option contract to purchase land and to a right of first refusal to purchase an interest in property."); Lantis v.

Courts adopting the minority view generally reach this conclusion by assuming that the sole policy underlying the rule against perpetuities is the elimination of restraints on alienation. Based on this distinction, the minority view contends that, unlike ordinary options, at least some rights of first refusal do not restrain alienation. Consequently, the minority view concludes that such rights of first refusal should not be subject to the rule against perpetuities.[117] Thus, in effect, the minority view postulates that an interest should not be subject to the rule against perpetuities unless the interest constitutes a restraint on alienation. The minority view distinguishes rights of first refusal from ordinary options.[118]

But dissenters have harshly criticized the minority position. For example, in *Ferrero Construction Co. v. Dennis Rourke Corp.*, the Maryland

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Cook, 69 N.W.2d 849, 852 (Mich. 1955) ("[A]n option, exercisable upon the happening of a condition precedent, is not regarded as a direct restraint on alienation and is everywhere held valid even though it specifies a fixed price, except that in jurisdictions where the rule against perpetuities is in effect as to lands, it would be void if exercisable beyond lives in being and 21 years."); Lake of the Woods Assoc. v. McHugh, 380 S.E.2d 872, 874 (Va. 1989) (rejecting a request to treat first-refusal provision as a procedural right that could be saved by a retroactive application of the wait-and-see doctrine). *But see* First Apostolic Lutheran Church v. Bekkala, No. 252866, 2005 WL 2086137, at *2 (Mich. Ct. App. Aug. 30, 2005) (stating that where option did not specify particular time period for exercise, but limited it by reference to grantee's ceasing to use the property for specific purposes, the option was not an invalid restraint on alienation); Murphy Exploration & Prod. Co. v. Sun Operating Ltd. P'ship., 747 So. 2d 260, 265 (Miss. 1999) ("Mississippi, like many jurisdictions, has modified the draconian effect of this rule with the wait and see doctrine."); Heather M. Marshall, Note, *Instead of Asking "When," Ask "How": Why the Rule Against Perpetuities Should Not Apply to Rights of First Refusal*, 44 NEW ENG. L. REV. 763 (2010) (arguing that *Bortolotti v. Hayden*, 866 N.E.2d 882 (Mass. 2007), which held, as matter of first impression, that rule against perpetuities did not bar right of first refusal contained in deed, was decided correctly and that other courts should follow the minority rule).

[117] *See, e.g.*, Weber v. Tex. Co., 83 F.2d 807, 808 (5th Cir. 1936); Forderhause v. Cherokee Water Co., 623 S.W.2d 435, 438–39 (Tex. Ct. App. 1981); Robroy Land Co. v. Prather, 6223 P.2d 367, 370 (Wash. 1980); Hartnett v. Jones, 629 P.2d 1357, 1361 (Wyo. 1981).

[118] *See* VI AMERICAN LAW OF PROPERTY § 26.64 (A. James Casner ed., 1952) ("An option creates in the optionee a power to compel the owner of property to sell it at a stipulated price whether or not he is willing to part with ownership. A pre-emption does not give to the pre-emptioner the power to compel an unwilling owner to sell; it merely requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the pre-emption, at the stipulated price. Upon receiving such an offer, the pre-emptioner may elect whether he will buy. If he decides not to buy, then the owner of the property may sell to anyone.").

Court of Appeals stated that the position confuses the rule against perpetuities with the rule against restraints on alienation:

> Even assuming the validity of the distinction between rights of first refusal and other options, the minority view errs in assuming that an interest should not be subject to the Rule unless the interest constitutes a restraint on alienation. In making this assumption, courts adopting the minority view confuse the Rule Against Perpetuities with the rule against unreasonable restraints on alienation. Admittedly, both rules belong to "a family of related rules that regulate the devolution of wealth from generation to generation." These two rules are nonetheless distinct. The Rule Against Perpetuities prevents property interests from vesting remotely. The rule against restraints on alienation, on the other hand, prevents grantors from unreasonably depriving grantees of the power to alienate their estates.
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> The policies underlying these two rules are likewise not identical. Obviously, the rule against restraints on alienation serves to facilitate the alienability of property. Similarly, one of the purposes of the Rule Against Perpetuities is to facilitate the alienability of property. Contrary to the minority view, however, the Rule Against Perpetuities is not simply a rule against restraints on alienation. Instead, the Rule Against Perpetuities is concerned with restrictions that render title uncertain. Without the Rule Against Perpetuities, it would be possible at some distant point for a remotely vesting future interest to divest the current owner's estate. Because of this threat of divestment, the owner might be deterred from making the most effective use of the property, even if he never has any desire to alienate his estate. Thus, by voiding certain remotely vesting future interests, the Rule Against Perpetuities eliminates this deterrent both for owners who wish to alienate their estates and for owners who have no intention of ever doing so. Consequently, from the standpoint of the Rule Against Perpetuities, it is irrelevant whether a particular future interest imposes a light burden,

> a heavy burden, or no burden at all upon the alienability of property.[119]

Clearly stating the intention of the parties with regard to how and when an interest vests is important.[120] The purposes of the rule against perpetuities include the facilitation of alienation of property and the maintenance of certainty of title.[121] The term *vested* also has another meaning: *transmissible*.[122] Vesting, in that secondary sense, is not sufficient to escape the rule against perpetuities. Instead, the interest must vest in the sense of becoming a vested remainder.

Regarding generally recognized exceptions to the rule against perpetuities and options to purchase real estate, the *Ferrero* court stated the following:

> In the area of options, courts in the 300 years since the High Court of Chancery decided the Duke of Norfolk's Case, have developed three exceptions to the Rule Against

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[119] *Ferrero Constr. Co.*, 536 A.2d at 1142–43 (citations omitted); *see also* J. A. Bryant, Jr., Annotation, *Pre-emptive Rights to Realty as Violation of Rule Against Perpetuities or Rule Concerning Restraints on Alienation,* 40 A.L.R.3D 920 (1971).

[120] S*ee, e.g.*, Fitzpatrick v. Mercantile-Safe Deposit & Trust Co., 155 A.2d 702, 705 (Md. 1959) (holding that the rule against perpetuities does not invalidate "interests which last too long, but interests which vest too remotely; in other words the [r]ule is not concerned with the duration of estates, but the time of their vesting").

[121] *See* Emerson v. Campbell, 84 A.2d 148, 155 (Del. Ch. 1951); *see also Stuart Kingston*, 596 A.2d at 1383 ("If there are two doubtful constructions of the meaning of an instrument, one consistent and the other repugnant to the law, the former will be adopted, but if the meaning is clear the rule must be observed since it is founded upon a sound principle of public policy and must be rigidly enforced. In projecting the prospect of vesting it is not enough that the future interests may, or even that it will in all probability, vest within the limits; it must necessarily so vest. If there is any possibility that the interest will vest beyond the period of the rule, then it is void *ab initio*" (citations and internal quotation marks omitted)); Curtis v. Md. Baptist Union Ass'n, 5 A.2d 836, 840 (Md. 1939) ("[T]he word vest as used in the law of property signifies the fixation of a present right to the immediate or future enjoyment of property." (internal quotation marks omitted)); Bloomer v. Phillips, 562 N.Y.S.2d 840, 840 (App. Div. 1990) ("[W]e note our disagreement with defendants' argument that . . . the rule against perpetuities applies in this case and invalidates the rights of plaintiffs. Assuming, without deciding, that the rule does apply, because the agreement was not made binding on plaintiffs' heirs and assigns the right of first refusal would necessarily terminate upon the deaths of plaintiffs. Therefore, the rule is not violated inasmuch as the right could not be exercised 'later than twenty-one years after one or more lives in being.'").

[122] JOHN CHIPMAN GRAY, THE RULE AGAINST PERPETUITIES § 118 (4th ed. 1942) ("Such double meaning is, however, very unfortunate, as it has led to much confusion.").

> Perpetuities. The Rule does not apply to a lessee's option to renew a lease. It does not apply to a lessee's option to purchase all or part of the leased premises. And it is inapplicable to a usufructuary's option to extend the scope of an easement or profit. All options may violate the Rule Against Perpetuities. Nevertheless, courts have justified these three narrow exceptions because these three types of options yield social benefits that offset the consequences of that violation.[123]

In a recent New York Court of Appeals decision, *Bleecker Street Tenants Corp. v. Bleeker Jones LLC*,[124] the court held that the rule against perpetuities does not apply to options to renew leases. The *Bleecker Street* court reasoned that "an option to renew, like a purchase option appurtenant to a lease, furthers the policy goals of the rule against remote vesting."[125] The court also noted that certain options appurtenant do not violate the rule against perpetuities if the option "(1) originates in one of the lease provisions, (2) is not exercisable after lease expiration, and (3) is incapable of separation from the lease."[126]

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[123] *Ferrero Constr. Co.*, 536 A.2d at 1140–41 (citations omitted); *see also* Cambridge Co. v. East Slope Inv. Corp., 700 P.2d 537, 542 (Colo. 1985) (holding that the rule against perpetuities did not apply to rights of first refusal contained in condominium declaration because condominium ownership was a form of property interest unknown to earlier common law, and that an exception for rights of first refusal to purchase this specialized type of property interest has little bearing on whether rights of first refusal in general should be exempt from the rule against perpetuities).

[124] 920 N.Y.S.2d 291 (2011).

[125] *Id.* at 294.

[126] *Id.* at 298 (internal quotation marks omitted) (quoting Symphony Space, Inc. v. Pergola Props. Inc., 646 N.Y.S.2d 641, 648 (1996)). The *Bleecker Street* decision may be limited in its general applicability because the court relied primarily on a specific New York statute to support its conclusion, and the case included a strong dissent and a concurring opinion that disagreed with much of the majority's reasoning. Several states have abolished or amended the rule against perpetuities or have pending legislation that would eliminate or amend the rule (including greatly extending the time period within which the right must vest). *See, e.g.*, COLO. REV. STAT. § 15-11-1102.5 (2001) (providing that under Colorado law a nonvested property interest is invalid unless it either vests or terminates within 1,000 years after its creation); S.C. CODE ANN. § 27-6-20 (1987) (providing that a nonvested property interest is invalid unless "(1) when the interest is created, it is certain to vest or terminate no later than twenty-one years after the death of an individual then alive; or (2) the interest either vests or terminates within ninety years after its creation"). In July 1990, The National Conference of Commissioners on Uniform State Laws approved and recommended the Uniform Statutory Rule Against Perpetuities (With 1990 Amendments) (USRAP) for enactment in all the states; twenty-six states, the District of Columbia, and the U.S. Virgin

In those states where options and related rights are subject to the rule against perpetuities, drafting around the problem may be possible to some extent. For example, it may be beneficial to record the option or related agreement, recite the statutory recording authority, and claim the priority of the statute with the same language as set forth in the option or related agreement. The option or related agreement also should be specific with respect to the rights and obligations of the parties and how, when, and under what circumstances the rightholder may exercise or transfer the option or related right to another party. The option or related agreement further should state that it lapses and ceases to constitute record notice in any event after a certain date. In addition, as is common with trusts,[127] attorneys might consider inserting a savings clause in the option document or right of first refusal affecting real property. Parties have used savings clauses with real estate contracts to ensure that they cannot close beyond the perpetuities period, and an option agreement or right of first refusal likewise should be protected if the document clearly states that the rightholder must exercise the option or right of first refusal within the applicable time limit imposed by the particular state rule.

VII. APPLICABILITY OF THE STATUTE OF FRAUDS

The statute of frauds generally applies to options and related rights.[128] In *A.S. Reeves & Co. v. McMickle*,[129] the Georgia Court of Appeals stated the following rule:

Islands have enacted USRAP. The comment to Section 4 of USRAP clearly indicate that the statutory rule against perpetuities requirements exclude options, rights of first refusal, and related transactions (unless they are of a donative nature, which is rare):

> In line with long-standing scholarly commentary, [Section 4(1)] excludes . . . nonvested property interests and powers of appointment arising out of a nondonative transfer. The rationale for this exclusion is that the Rule Against Perpetuities is a wholly inappropriate instrument of social policy to use as a control on such arrangements. The period of the rule—a life in being plus 21 years—is not suitable for nondonative transfers . . . .

UNIF. STATUTORY RULE AGAINST PERPETUITIES § 4 cmt., 8B U.L.A. 280 (2001).

[127] *See* JESSE DUKEMINIER ET AL., PROPERTY 249 (6th ed. 2006) (suggesting savings clause language for trusts); W. Barton Leach & James K. Logan, *Perpetuities: A Savings Clause to Avoid Violations of the Rule*, 74 HARV. L. REV. 1141 (1961).

[128] *See, e.g.*, Kaplan v. Lippman, 552 N.Y.S.2d 903, 905 (1986) (emphasizing that the creation or execution, and not the exercise, of the option must satisfy the statute of frauds, and stating that "[b]ecause an option to purchase an interest in real property is in effect a conditional contract for a future conveyance of land, a contract that creates such an option is within the Statute of Frauds"). *But see* Bero Motors, Inc. v. Gen. Motors Corp., No. 257675,

> An option contract for the sale of realty comes within the Statute of Frauds and writings relied on to take the transaction out of the Statute of Frauds must (a) identify the buyer and seller, (b) describe the subject matter of the contract, and (c) name the consideration. . . .
>
> Option contracts for the sale of realty require the same degree of definiteness as general contracts. The required definiteness includes such matters as the price, and the terms of payment. The contract must either state the price to be paid for the property or set forth criteria by which it may be calculated. The offer must be complete and definite in all respects, since it becomes a contract on acceptance.[130]

VIII. RELATION BACK OF EXERCISE OF OPTION OR RELATED RIGHT

Depending on applicable state law, an option or related right in real property, when effectively and completely exercised, will relate back to the date the right was granted and will not be subject to intervening interests if the rightholder recorded the option or other right in the land records when granted.

In an unusual case decided by the California Court of Appeal, *Wachovia Bank v. Lifetime Industries, Inc.*,[131] an optionee that held an option to purchase certain real property sued a building contractor that had recorded a mechanic's lien against the property, seeking specific enforcement of its rights under an option to purchase real estate. The court found insufficient evidence to establish that the optionee obtained title to the property pursuant to the option or that the title extinguished the contractor's lien.[132]

2006 WL 2312182, at *2 (Mich. Ct. App. Oct. 10, 2006) (holding that Michigan's statute of frauds did not apply to option contracts or rights of first refusal, even if the underlying subject was land); Whiteside v. Petersen, 128 N.Y.S.2d 17, 19–20 (Sup. Ct. Spec. Term 1953) (holding that tenant is not entitled to specific performance unless it can produce written lease including "first option to buy" and written contract indicating owner's willingness to sell).

[129] 605 S.E.2d 857 (Ga. Ct. App. 2004).

[130] *Id.* at 859; *see also Whiteside*, 128 N.Y.S.2d at 19; *Kaplan*, 552 N.Y.S.2d at 905; Karl B. Holtzschue, HOLTZSCHUE ON REAL ESTATE CONTRACTS AND CLOSINGS § 1:2.6 (3d ed. 2007) ("An option must meet the requirements of the statute of frauds."). *But see Bero Motors*, 2006 WL 2312182, at *2.

[131] 52 Cal. Rptr. 3d 168 (Ct. App. 2006).

[132] *See id.* at 172.

The facts in this case were somewhat complex. Kmart Corporation sold an estate for years on the property in Perris, California to Shawmut Bank (Shawmut) and deeded the remainder interest (Remainder) to an entity called FGHK.[133] FGHK then sold to Shawmut Bank options to lease the land after the estate for years expired and the option to purchase the Remainder as provided in a certain "option and estate for years agreement" (the Option Agreement).[134] Shawmut (as owner of the estate for years) leased the property to Kmart. Shawmut paid $12,843 for the options provided for in the Option Agreement and could exercise the option to purchase the Remainder upon the occurrence of any of several specified events, including default of FGHK's duty to "keep the property 'free and clear of Optionor liens.'"[135] Additionally, Shawmut executed a deed of trust in favor of Bank of New York, by which Shawmut mortgaged its interest in the property, and a trust indenture, by which Shawmut assigned its interest in the Kmart lease and the Option Agreement to Bank of New York.[136] Bank of New York subsequently assigned the beneficial interest under the deed of trust to Wachovia as the Asset Trustee for Property Acquisition Trust 1993-22 (PAT).[137]

The optionee could exercise the option by notifying the optionor of its "desire to exercise" the option.[138] Upon the closing of the purchase of the Remainder, title was to be "conveyed by special warranty deed free and clear of all Liens, except Permitted Liens."[139] The Option Agreement was recorded on January 3, 1994. Defendant, Lifetime Industries, Inc. (Lifetime), later recorded a mechanic's lien against the property in 2002. In May 2003, PAT bought the deed of trust at a foreclosure sale, acquiring the estate for years and the rights of the optionee under the Option Agreement. FGHK continued to own the Remainder.

In January 2004, Lifetime obtained a judgment from the Riverside County Superior Court against FGHK for $837,795, including a lien upon the ownership interest of FGHK in the property and an order to sell FGHK's interest in the property at public auction (the Lifetime Judgment). PAT then served on FGHK a written notice of its intent to exercise the op-

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[133] *See id.* at 170.
[134] *See id.*
[135] *Id.* at 171.
[136] *See id.* at 170.
[137] *See id.* at 171.
[138] *See id.*
[139] *Id.*

tion to purchase the Remainder pursuant to the Option Agreement because FGHK failed to release, vacate, or fully bond the Lifetime Judgment. FGHK argued in response "that the Kmart lease had terminated and that PAT, as the optionee and owner of the estate for years, had the duty to protect the [p]roperty against [Lifetime's] mechanic's lien."[140] PAT, in turn, argued that this response amounted to a rejection of the Option Agreement. PAT then filed a complaint in state court against Lifetime and FGHK, including the following counts: declaratory relief against Lifetime, quiet title against all defendants, and specific performance against FGHK. PAT also asked the court to compel FGHK "to deliver to PAT a special warranty deed of the Remainder immediately upon PAT's tender of the purchase price." PAT also alleged that title to Remainder should "relate back to January 3, 1994, the date the Option was granted, . . . free and clear of any subsequent liens."[141]

FGHK answered the complaint by alleging that PAT had breached the Option Agreement and that nothing obligated FGHK to convey title to the Remainder to PAT.[142] PAT sought a declaration that:

> (1) PAT's interest in the Remainder, as represented by the Option Agreement . . . , the Exercise Notice, and (when executed . . .) the FGHK Deed, is prior to and superior to Defendant Lifetime's purported interest in the Remainder, as represented by the Lifetime Judgment. FGHK further argued that PAT's title to the Remainder related back to the date the Option was granted in 1994 and therefore extinguished Lifetime's interest in the Remainder under the Lifetime Judgment.[143]

After reviewing the respective parties' arguments and assertions, the trial court granted PAT's motion and subsequently entered judgment against Lifetime.[144] On appeal, PAT asserted that the quitclaim deed to the Remainder from FGHK to PAT, which was dated "two months after the hearing on the summary judgment motion," triggered the relation-back doctrine.[145] But

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[140] *Id.* at 172.
[141] *Id.*
[142] *See id.*
[143] *Id.*
[144] *See id.* at 173.
[145] *Id.* at 174.

the appellate court noted PAT submitted no evidence showing that its receipt of the quitclaim deed was pursuant to its exercise of the option.

The court noted that, under California law, the title the optionee received relates back to the date the optionor gave the option and extinguishes the interest of the intervening party: "Until title is transferred, the optionee, after exercising the option, holds only a right to complete the purchase, enforceable by specific performance; intervening interests, while subject to this right, are not yet extinguished."[146]

The court also stated the following: "PAT does not state that FGHK ever delivered a deed to the Remainder to PAT or that PAT otherwise has obtained title to the Remainder. . . . At most, the evidence submitted to the trial court shows that PAT gave notice that constitutes an exercise of the option to purchase."[147]

Relying on PAT's own admission that FGHK continued to hold the Remainder, the court ruled that "Lifetime's lien against FGHK's interest in the Remainder ha[d] not been extinguished."[148] The court also ruled that the quitclaim deed from FGHK to PAT, without more, was insufficient to support a finding in favor of PAT.[149] The court noted the title that relates back to the date of the option must bear some relationship to the option and stated that "while the relation-back rule is well settled, the nature of this rule has not been clearly explained by the California cases that have relied on it."[150] The court reasoned that "something more than the mere fact that the optionee subsequently acquired title is required before the purchaser has the benefit of the relation-back rule."[151] The court held that "justification for the relation-back rule does not apply when the optionee obtains title to the property despite the failure of a condition, expiration of the option, or a material breach by the optionee that would preclude specific performance."[152] In this case, according to the court, the evidence of the quitclaim deed (if it even decided to take such evidence) did not necessarily comply with the requirements for application of the relation-back rule. The court gave two reasons for this determination. First, FGHK initially denied PAT's right to

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[146] *Id.* at 176.

[147] *Id.* at 178. The court further stated that "the mere exercise of the option, without the consummation of the purchase and sale transaction, does not provide PAT with title to the Remainder." *Id.*

[148] *Id.*

[149] *See id.* at 179.

[150] *Id.*

[151] *Id.*

[152] *Id.* at 180.

acquire the Remainder because PAT allegedly breached the Option Agreement and was not entitled to specific performance (although the court never determined the issues in this action). Second, FGHK eventually issued a quitclaim deed to PAT rather than the special warranty deed required by the option agreement.[153] According to the court, "PAT could not have obtained the deed from FGHK by operation of the terms of the option, but was required to fulfill an additional condition—the resolution of the PAT–Lifetime dispute—as part of a new agreement between the parties."[154] The court held that the record provided insufficient evidence to find that PAT obtained title pursuant to the option or that the acquisition of such title extinguished Lifetime's recorded mechanic's lien.[155]

Finally, the court rejected Lifetime's argument that a California statute, which protected lenders that granted purchase options in connection with loans secured by real property, applied in the present case.[156] The court held that "there is nothing to indicate that the legal relationship between FGHK and Shawmut Bank was anything more than optionor and optionee under the Option Agreement."[157] The court noted further that the word *collateral* in the statute refers to collateral that secures a debt owed by the debtor-optionor to the secured party-optionee, and that the present parties owed no debt to each other.[158]

As noted above, the court ruled that the mere exercise of the option, without consummation of the purchase and sale transaction, did not provide PAT with title to the Remainder, even with the subsequent delivery of a quitclaim deed to the property. The court, while perhaps reluctant to reach this conclusion, reasoned that a judgment in favor of PAT, based on the facts of this case, could foster collusion on behalf of the optionor and optionee that should not be encouraged as a matter of public policy. As an example, the court described a situation in which PAT might exercise its option and thereby extinguish the intervening Lifetime lien, yet subsequently fail to tender the purchase price for the Remainder or be unable to obtain title to the Remainder because of a failure of a condition to closing or a contractual breach by PAT.[159] Under such circumstances, the court believed

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[153] *See id.*
[154] *Id.*
[155] *See id.*
[156] *See id.*
[157] *Id.* at 178.
[158] *See id.*
[159] *See id.*

that FGHK unjustly would retain title to the Remainder free and clear of the Lifetime lien.[160] In this case, the court reasoned that PAT took title to the property "outside the purview of the option," meaning that the optionee would not have been entitled to specific performance and that the relation-back rule should not apply.[161] "[T]he optionee should be in the same position as any other purchaser of the property, and the ordinary rules of priority should apply."[162] Also, the court noted that "PAT submitted no evidence showing that its receipt of the quitclaim deed was pursuant to its exercise of the option."[163]

PAT's approach to this case may have been counterproductive in that it (1) failed to resolve the initial issues (the claims were dismissed) regarding FGHK's original claim that PAT was not entitled to acquire the Remainder pursuant to its option right because PAT's alleged breach of the Option Agreement disqualified it from receiving specific performance; (2) obtained from FGHK a quitclaim deed to the Remainder instead of the special warranty deed required by the Option Agreement; (3) waited to obtain the quitclaim deed until two months after the hearing on the summary judgment motion; and (4) failed to state specifically in the deed that the deed was being granted and delivered pursuant to PAT's exercise of its option right as set forth in the Option Agreement.

IX. ENFORCEABILITY OF OPTIONS AND RELATED RIGHTS IN BANKRUPTCY

In bankruptcy proceedings, a question may arise as to whether section 365(f)(1) of the Bankruptcy Code renders an option or right of first refusal contained in a lease unenforceable. Section 365(f)(1) provides that, "notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease" if the trustee assumes the lease and provides adequate assurance of future performance.[164] As a consequence, when a debtor in possession wishes to assign an executory contract, section 365(f)(1) renders unenforceable not only provisions that prohibit assignment outright but also provi-

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[160] *See id.* at 180.

[161] *Id.*

[162] *Id.*

[163] *Id.* at 174.

[164] 11 U.S.C. § 365(f)(1) (2006).

sions that are so restrictive that they constitute de facto anti-assignment provisions.

The bankruptcy court, in *In re E-Z Serve Convenience Stores, Inc.*,[165] held that the landlord's right of first refusal to purchase buildings and permanent improvements constructed by the debtor-tenant on the leased land was enforceable and that the court would not excise the right. The bankruptcy trustee sought the court's approval to assume, assign, and sell to a third party the debtor-lessee's interest under the lease free and clear of the landlord's right of first refusal.[166] The trustee argued that the right of first refusal was unenforceable under section 365(f) as an impermissible restraint on the assignability of the lease.[167] The court noted that "courts have applied 365(f) to 'lease provisions that are so restrictive that they constitute de facto anti-assignment provisions,'"[168] and stated that, "[w]hile a trustee is required to assume a contract as a whole, the court may strike provisions that are contrary to the provisions of the Bankruptcy Code such as those that place restrictions on assignment."[169]

The bankruptcy court ruled in favor of the landlord based on the following undisputed facts: (1) the landlord had submitted the highest bid for the property; (2) the parties specifically and heavily negotiated the clause as consideration for below-market rent; (3) the landlord planned to develop the adjacent land; and (4) the clause was necessary to protect the landlord from violating a noncompete clause in a lease to another party on nearby property.[170] The court commented on a trend in bankruptcy cases dealing with a right of first refusal:

> Numerous courts have recognized a right of first refusal with no analysis of the application of 365(f). A review of these cases reveals that the concern of these courts when presented with a contractual right of first refusal is not whether to enforce such right, but how to incorporate a right of first refusal into the bidding and sale procedures of

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[165] 289 B.R. 45 (Bankr. M.D.N.C. 2003).

[166] *See id.* at 47.

[167] *See id.* at 49.

[168] *Id.* at 50 (quoting *In re* LaSalle Nat'l Trust, 288 B.R. 114, 123 (E.D. Va. 2003)).

[169] *Id.* at 49.

[170] *See id.* at 48–49, 55.

> the bankruptcy auction in a fair and equitable manner that still allows for maximization of the value of the estate.[171]

The court also stated that the majority of courts hold that a right of first refusal is an executory contract, but noted that "[w]hether the right of first refusal is part of a larger executory contract or lease, or stands alone, should not alter the treatment of that right. The Trustee has chosen to assume the lease, which includes [the landlord's] right of first refusal."[172]

This ruling was a fact-specific decision, and the court decided for the landlord, as the holder of the first right of refusal, based on the following evidentiary findings: (1) the landlord presented uncontested evidence of economic harm to him if the court did not enforce the provision; (2) the right of first refusal was a material and bargained-for provision of the lease, with consideration to the debtor-tenant in the form of below-market rent; (3) enforcing the right had chilling effect on the sale of the property; (4) the right of first refusal did not restrict or burden the assignment of the lease and therefore did not fall within the framework of section 365(f)(1); (5) absent the right of first refusal, the trustee could not give adequate assurance of future performance; (6) the landlord's offer was equal or better than the terms of competing offers; (7) the court had not yet entered a final order approving the sale; and (8) disregarding the landlord's interest gave no apparent benefit to the estate but posed a clear detriment to the holder of the interest and therefore would be unfair and inequitable.[173]

The court also noted that it "retains some discretion in determining whether a lease provision that does not explicitly prohibit assignment qualifies as a de facto anti-assignment clause thereby rendering it unenforceable."[174] The court stated further that it "disagrees with the conclusion that the statutory language of § 365(f)(1) renders any right of first refusal unenforceable and finds that [the landlord's] right of first refusal is not within the scope of § 365(f)."[175]

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[171] *Id.* at 52–53 (citations omitted).

[172] *Id.* at 53 n.4.

[173] *See id.* at 51–54.

[174] *Id.* at 50; *see also In re* Nickels Midway Pier, LLC, 372 B.R. 218, 225 (D.N.J. 2007) ("[A] determination of the parties' relative obligations under the Lease, if any, will inform [the debtor's] determination whether, in its business judgment, rejection of the Lease is appropriate.").

[175] *In re E-Z Serve*, 289 B.R. at 51. The court referred to the decisions in *In re Auto Trak Corp.*, 277 B.R. 655, 671 (Bankr. E.D. Va. 2002), and *In re Rickel Home Centers, Inc.*, 240 B.R. 826, 831–32 (D. Del. 1999), in its analysis of whether it should apply section

The *E-Z Serve* case highlights the importance of specifically stating, in the lease provision setting forth an option right or first right of refusal, that the parties bargained for the right, that the right was a material part of the lease, and that the rightholder would experience an economic detriment if the court did not uphold the right.[176]

As noted earlier in this article, unlike an option, a right of first refusal does not entitle the holder of the right to force the other party to sell or lease the real property. Instead, if and when the other party decides to sell or lease the property to any third party, the holder of the right of first refusal can require the owner to sell or lease the property to him for the same price and terms that the owner is willing to accept from the third party. As also noted earlier in this article, a right of first refusal is less desirable from the standpoint of the holder than an option because a right of first refusal does not set the price for the property in advance, and it allows the owner of the property to decide whether and when to sell or lease. A property owner generally will resist granting a right of first refusal because of its chilling effect on the marketability of the property. However, the *E-Z Serve* court specifically found that "there is no evidence that the existence of a right of first refusal had a chilling effect on the sale procedure."[177] The court made this determination because the testimony demonstrated that the party that submitted the bid that the trustee accepted did so without knowledge of the landlord's first right of refusal, and the landlord was not aware of the amount of any com-

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365(f) to lease provisions that are so restrictive that they should be deemed de facto impermissible anti-assignment provisions.

[176] *Cf. In re* Adelphia Commc'ns Corp., 359 B.R. 65, 86 n.71 (Bankr. S.D.N.Y. 2007). ("A bankruptcy court retains discretion in determining whether a provision in an executory contract hinders the possibility of assignment to a sufficient degree to render it unenforceable."). The *Adelphia* court distinguished the *E-Z Serve* case:

> The *E-Z Serve* court . . . was in a position to find that permitting exercise of the right of first refusal would not be a detriment to the debtor's estate, and that there appeared to be no benefit to the estate of allowing the sale to the winning bidder to proceed. Here the Court can make none of those findings.

Id. at 88. *See also In re* IT Group, Inc., 302 B.R. 483, 488 (D. Del. 2003) ("[T]he Bankruptcy Court does retain some discretion in determining whether provisions that do not explicitly prohibit assignment qualify as de facto anti-assignment clauses rendering them unenforceable. . . . In the circumstances of this case, the Court agrees with the Bankruptcy Court that the right of first refusal is not an unenforceable restraint on assignment.") (citation omitted); *In re* Mr. Grocer, Inc., 77 B.R. 349, 352–53 (Bankr. D.N.H. 1987) (holding right of first refusal unenforceable under facts of the case).

[177] *In re E-Z Serve*, 289 B.R. at 51.

peting bids because it had submitted a bid that was $51,000 more than the bid submitted by the trustee for approval by the bankruptcy court.[178]

Section 365(a) of the Bankruptcy Code enables the debtor in possession or bankruptcy trustee in Chapter 11 proceedings, subject to court approval, to assume or reject any executory contract or unexpired lease held by the debtor.[179] A court may consider an option to purchase (or related right, such as a right of first refusal) an executory contract under section 365(a) that the debtor in possession or bankruptcy trustee could assume or reject.[180] The Bankruptcy Code does not define the term executory contract.[181] Courts generally define an executory contract as a contract in which both parties have unperformed obligations.[182]

In *Unsecured Creditors' Committee of Robert L. Helms Construction & Development Co. v. Southmark Corp.* (*In re Robert L. Helms Construction & Development Co.*),[183] the U.S. Court of Appeals for the Ninth Circuit held that whether an option is an executory contract depends on whether the option requires further performance from each party at the time of the bankruptcy petition's filing. The court also held that performance due at the sole discretion of the optionee—that is, the optionee's decision of whether or not to exercise the option—"doesn't count unless he has chosen to exercise it."[184] The court stated that an option to purchase might on occasion be deemed an executory contract "where the optionee has announced that he is

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[178] *See id.*

[179] *See* 11 U.S.C. § 365(a) (2006).

[180] *See id.*

[181] *See id.*

[182] *See* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522 n.6 (1984) (holding that an executory contract is one "on which performance remains due to some extent on both sides"); Griffel v. Murphy (*In re* Wegner), 839 F.2d 533, 536 (9th Cir. 1988) (ruling that a contract is executory if "the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other"); Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1045 (4th Cir. 1985) (adopting the Countryman test "for determining whether a contract is 'executory' in the required sense"); *In re* Anchor Resolution Corp., 221 B.R. 330, 337 (Bankr. D. Del. 1998) (citing Enter. Energy Corp. v. United States (*In re* Columbia Gas Sys. Inc.), 50 F.3d 233, 239 (3d Cir. 1995)); Vern Countryman, *Executory Contracts in Bankruptcy: Part 1*, 57 MINN. L. REV. 439, 460 (1973).

[183] 139 F.3d 702 (9th Cir. 1998).

[184] *Id.* at 706.

exercising the option, but [has] not yet followed through with the purchase at the option price."[185]

The majority of cases that have dealt with this issue hold that an option to purchase (or a right of first refusal) is an executory contract that can be rejected under section 365(a) of the Bankruptcy Code.[186] Other bankruptcy court decisions, however, hold that under certain circumstances an option or related contract is not an executory contract.[187]

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[185] *Id.* The Ninth Circuit in *In re Helms* expressly overruled its previous decision in *Gill v. Easebe Enterprises* (*In re Easebe Enterprises*), 900 F.2d 1417 (9th Cir. 1990), which held that all options were executory contracts.

[186] *See, e.g.*, *In re* E-Z Serve Convenience Stores, Inc., 289 B.R. 45, 53 n.4 (Bankr. M.D.N.C. 2003) ("Some courts have also discussed the issue of whether a right of first refusal is an executory contract. The majority of courts hold that it is an executory contract."); *In re* Kellstrom Indus., Inc., 286 B.R. 833, 834–35 (Bankr. D. Del. 2002) ("[W]e conclude, like the majority of the courts before us, that the right of first refusal . . . is an executory contract which may be rejected by the Debtors under section 365."); *In re* Emerald Forest Constr., Inc., 226 B.R. 659, 665 (Bankr. D. Mont. 1998) (ruling that an option to purchase granted in connection with an equipment lease was an executory contract where "the [debtor in possession] has announced, but has not followed through," and that "[t]he lease and purchase option remain executory and subject to the requirements of Section 365(b)(1), which the [debtor in possession] has not satisfied"); *see also* Rivercity v. Herpel (*In re* Jackson Brewing Co.), 567 F.2d 618, 623–24 (5th Cir. 1978); *In re* Waldron, 36 B.R. 633, 636–40 (Bankr. S.D. Fla. 1984), *rev'd on other grounds*, 785 F.2d 936 (11th Cir. 1986); Horton v. Rehbein (*In re* Rehbein), 60 B.R. 436, 441 n.6 (B.A.P. 9th Cir. 1986); Steffan v. McMillan (*In re* Coordinated Fin. Planning Corp.), 65 B.R. 711, 713 (B.A.P. 9th Cir. 1986); *In re* G-N Partners, 48 B.R. 462, 465 (D. Minn. 1985); *In re* Fleishman, 138 B.R. 641, 646–47 (Bankr. D. Mass. 1992); *In re* A.J. Lane & Co., 107 B.R. 435, 437 (Bankr. D. Mass. 1989); *In re* Hardie, 100 B.R. 284, 287 (Bankr. E.D.N.C. 1989).

[187] *See, e.g.*, *In re* Bergt, 241 B.R. 17, 19–20 (Bankr. D. Alaska 1999) (holding that right of first refusal possessed by another owner in subdivision was not an executory contract that Chapter 11 debtors could reject, where no sale of subject property was pending at time of debtors' bankruptcy filing); Brown v. Snellen (*In re* Geising), 96 B.R. 229, 232 (Bankr. W.D. Mo. 1989) (holding that option to purchase in instant case was not executory because lease and option were separate contracts and breach of lease would not trigger breach of option to purchase); Bronner v. Chenoweth-Massie P'ship (*In re* Nat'l Fin. Realty Trust), 226 B.R. 586, 590 (Bankr. W.D. Ky. 1998) ("[A]n option contract is not an executory contract requiring assumption under § 365."); *see also In re* Lewis, 94 B.R. 789, 795 (Bankr. D. Mass 1988); Travelodge Int'l, Inc. v. Cont'l Props., Inc. (*In re* Cont'l Props., Inc.), 15 B.R. 732, 736 (Bankr. D. Haw. 1981). *But see* Kaonohi Ohana, Ltd. v. Sutherland (*In re* Kaonohi Ohana, Ltd.), 873 F.2d 1302, 1306 n.5 (9th Cir. 1989) ("[S]pecific performance of a rejected executory contract cannot be required."); *In re* CB Holding Corp., 448 B.R. 684, 689 (Bankr. D. Del. 2011) ("The Court has already found the *Bergt* decision unpersuasive and contrary to the majority of courts which have held that a right of first refusal is an executory contract subject to rejection under section 365."). *See generally* 3 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE 2D § 49.13 (1997); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 COLO. L. REV.

A frequently litigated issue in bankruptcy courts is whether a debtor-landlord's actual or deemed rejection of a lease terminates all of the tenant's rights under a lease (including an option or related right). Under section 365(h) of the Bankruptcy Code, a landlord (or the bankruptcy trustee) who files for relief under the Bankruptcy Code has the right to reject any lease, subject to bankruptcy court approval.[188] The tenant then has the right under section 365(h)(1)(A) either to (1) treat the lease as terminated and vacate the space or (2) remain in possession for the balance of the lease term and any renewal or extension.[189] Section 365(h)(1)(A)(ii) provides that the tenant may retain those rights in the lease that are in or appurtenant to the real property, "including rights such as those relating to the amount and timing of payment of rent and . . . any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation" to the extent that such rights are enforceable under applicable nonbankruptcy law.[190]

Because the tenant under a rejected lease may retain its rights under the lease, such rights arguably could apply to a tenant's option to purchase or a related right contained in the lease if the right is enforceable under applicable state law (assuming that such option to purchase or related right contained in the lease is a right in or appurtenant to the real property). Such a right would then, at the tenant's election, survive rejection of the lease by the landlord-debtor or the bankruptcy trustee. Although section 365(h)(1)(A)(ii) does not explicitly list an option among the surviving tenant rights stated in section 365(h)(1)(A)(ii), the language in this section is clear that it is only listing specific rights as examples and not as an exclusive list of such rights.

In *In re Bergt*, the Alaska bankruptcy court ruled that the debtor-owner's rejection of a contract that granted a right of first refusal to purchase property to a nondebtor party (an adjoining landowner) did not terminate the right, and that the right was enforceable by specific performance if and when the debtor-owner subsequently decided to sell the property.[191] The

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845, 898–99 (1988) (discussing the inappropriateness of a balancing test regarding executory contracts); John C. Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. 279, 312 n.104 (1998) (discussing executory contracts).

[188] *See* 11 U.S.C. § 365(h) (2006).

[189] *See id.* § 365(h)(1)(A).

[190] *Id.* § 365(h)(1)(A)(ii).

[191] *See In re* Bergt, 241 B.R. 17, 21 (Bankr. D. Alaska 1999) (ruling that, based on the holding of the Ninth Circuit in *In re Helms*, an option agreement—or at least one that was not in the process of being exercised at the time of the bankruptcy filing—is not an executory contract that the debtor-owner can reject).

court in *In re Bergt* noted that "[t]he trend of the law is . . . that rights created by state law in a specific asset (for example, the right of a nondebtor optionee to purchase land) are not avoidable by rejection under 11 U.S.C. § 365(a) alone."[192] The court also stated that "bankruptcy law recognizes third parties' equitable interests in property, including interests the essence of which is the right to obtain the specific property," and "rejection protects the estate from the financial obligation of affirmatively performing the debtor's obligations—but, this does not mean that the nondebtor's property rights in estate property should be cut off, and if necessary, enforcement of thus [sic] rights may be by specific performance."[193] The court further stated that "nondebtor's rights are protected in other situations—e.g., secured creditors' rights trump the equality of distribution policy."[194]

The court distinguished other cases holding that rejection is the equivalent of termination because those cases involved debtor-tenants, and not debtor-landlords, who had granted rights to a nondebtor in the debtor-landlord's property.[195] However, the court acknowledged that "a few cases . . . hold that a rejection of an executory contract or lease terminates it, and any rights a nondebtor may have had under state law in the property involved," including the avoidance of an option or contract to sell the property.[196]

Section 365(i) of the Bankruptcy Code also affects the rights of a holder of an option to purchase or a related right contained in a lease. Section 365(i)(1) provides that if the bankruptcy trustee (or debtor in possession) rejects an executory contract for sale of the property under which the nondebtor-purchaser is in possession, the nondebtor-purchaser may treat the contract as terminated or choose to remain in possession of the real property.[197] Section 365(i)(2)(A) and (B) provide that if the nondebtor-purchaser elects to remain in possession, it shall continue to make all payments under the contract (subject to offset rights for nonperformance of any of the debtor's lease obligations), and the trustee or debtor in possession must deliver

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[192] *Id.* The court also stated that "[t]he holder of [a right of first refusal] cannot compel a sale, but has a preemptive right to buy when the owner decides to sell. It is sometime characterized as a 'conditional option' or as a 'preemptive option.'" *Id.* at 20 (footnotes omitted).

[193] *Id.* at 23.

[194] *Id.* at 24.

[195] *See id.* at 30.

[196] *Id.* at 31.

[197] *See* 11 U.S.C. § 365(i)(1).

title to the purchaser in accordance with the provisions of the purchase contract.[198]

When the lease contains an option to purchase or related right in favor of the nondebtor-tenant, section 365(i) of the Bankruptcy Code should allow the nondebtor-tenant to exercise the option or related right (even if the debtor-landlord rejects the lease) and should entitle the nondebtor-tenant to a deed to the property upon such exercise.[199] As noted earlier, section 365(h) allows a nondebtor-lessee under a rejected real estate lease either to remain in possession for the remainder of the lease term or to treat the lease as terminated.[200] Therefore, even if the nondebtor-lessee of a rejected lease could not compel transfer of title to the property under section 365(i) of the Bankruptcy Code, it still has the rights provided under section 365(h).[201]

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[198] *See id.* § 365(i)(2)(A)–(B).

[199] *See id.* § 365(i).

[200] *See id.* § 365(h)(1)(A).

[201] *See, e.g.*, *In re* Nickels Midway Pier, LLC, 341 B.R. 486 (Bankr. D.N.J. 2006). In that case, the court held that an oral agreement granted to the tenant to purchase the property was independent of the lease term, and the lease provisions continued even if the purchase agreement did not close. *See id.* at 496–97.The court also noted that (1) the lease did not provide that a breach of its terms would terminate the purchase option; (2) the lease and sale agreement provided for separate consideration; (3) the lease payments were not credited against the purchase price; and (4) the landlord-debtor and the lessee entered into the lease and sale contracts on separate occasions. *See id.* at 495–96. The court ruled that the tenant-optionee could remain in possession under the lease pursuant to section 365(h)(1)(A) of the Bankruptcy Code but that it was not a purchaser in possession within the meaning of § 365(i). *See id.* at 501. But the court remanded the case to the bankruptcy court: "Although § 365(i) is inapplicable, if the Bankruptcy Court approves the rejection by [the landlord] of either the Lease or the oral contract for sale, it should consider whether other statutory provisions such as § 365(h), offer protection to [the lessee]." *Id.* As a result of the court's decision in *In re Nickels*, it may be best to draft the option to purchase or related right in a manner that will most likely preserve the lessee's right to benefits provided under section 365(i). This may be accomplished by including the option to purchase or related right as a provision within the lease agreement itself and not in a separate document with separate consideration. Also, the lease should contain a clause that the nondebtor-lessee is thereby in possession as a contract vendee (assuming that the bankruptcy occurs after the option or related right has been exercised). If the option or related right is contained in a separate document, the nondebtor-lessee may still have a claim against the landlord-optionor based on breach of the lease for failure to convey the property. However, this would be an unsecured claim with much less value to the holder of the option or related right.

X. CONTRACTUAL DEADLINES FOR THE EXERCISE OF OPTIONS AND RELATED RIGHTS

Provisions in legal documents granting options and related rights may contain language that requires the exercise of the option or related right in writing (or that an extension payment be delivered) not later than a certain date after the parties have entered into the initial contract. Normally, courts will strictly enforce these dates, even if the date for compliance would fall on a Saturday, Sunday, or holiday—especially if sophisticated businesspeople, who were represented by counsel, entered into the contracts and failed to mention "business days" when discussing the deadline date. But if a court believes that the optionor has unfairly taken advantage of the optionee or that other equitable considerations require the intervention of the court, the court will not uphold a strict interpretation of the deadline and will allow the optionee extra time to comply to avoid an unjust result. Such equitable decisions are, however, highly fact-specific and are the exception to the general rule.

Cases requiring strict compliance usually rely on the explicit and unambiguous language of the option agreement or other document and the clear intention of the parties. This reliance is especially true if no language refers to performance on a business day, yet an unrelated provision in the document clearly provides for the payment of certain sums on a business day.

For example, in *Metro Development Group, L.L.C. v. 3D-C & C, Inc.*,[202] the Florida District Court of Appeals affirmed the trial court's decision that an option contract requiring the optionee to make an option extension payment on a Saturday should render an extension payment made on the following Monday (the first business day after the day provided for in the option agreement) ineffective, thus terminating the rights of the option holder. The option contract provided that if Metro Development Group, L.L.C. (Optionee) chose not to terminate the option contract, it would have to make an additional escrow deposit of $20,000 and a payment of either $119,000 or $29,575 to 3D-C & C, Inc. (Optionor) to extend the option, depending on the length of the extension that the Optionee desired.[203] The option contract required that the Optionee make an additional escrow deposit and extension payment on or before the forty-fifth day after its effective date.[204] The contract also provided that "[a]t any time when these payments are not made within the time described, the purchaser[']s rights under this

[202] 941 So. 2d 11 (Fla. Dist. Ct. App. 2006).

[203] *See id.* at 12.

[204] *See id.*

contract will terminate [and the] obligations of the seller to the [p]urchaser shall terminate."[205] Another paragraph in the contract simply referred to the forty-fifth day and made no reference to business days.[206] In fact, the contract referenced business days in a provision that extended the time for the Optionee's inspection of the property "until the expiration of five (5) business days from the date cured or waived by the Purchasers, whichever last occurs."[207] The contract further contained a provision that "[t]ime is of the essence of this agreement."[208]

The court determined that August 18, 2004, was the effective date of the option contract and that the forty-fifth day after that date was Saturday, October 2, 2004.[209] On Friday, October 1, 2004, the Optionee paid an additional escrow deposit of $20,000 but failed to make the required extension payment of $29,575 until the following Monday, October 4, 2004. The Optionor rejected this payment as untimely and insufficient to extend the option, which the Optionor deemed terminated.[210] The escrow agent filed an interpleaded action to resolve this issue, and the Optionee filed a cross-claim seeking specific performance of the agreement or, alternatively, damages for breach of contract.[211] The Optionor filed motions to dismiss and for summary judgment, arguing that the option had expired because the Optionee had failed to timely make the required extension payment. The Optionee argued that a latent ambiguity existed because the parties had failed to address the specific situation of what would happen if the extension fell on a Saturday, Sunday, or holiday. The Optionee also claimed that the court should "look to custom and usage in the real estate industry and the conduct of the parties, both of which indicated that payment could be made on the *next business day* after the deadline."[212]

The trial court granted summary judgment for the Optionor, ruling that the contract was clear on its face and that no latent ambiguity existed.[213] The appellate court refused to consider any extrinsic evidence in ascertaining the parties' intent because it found that the contract's reference to the

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[205] *Id.* (internal quotation marks omitted).
[206] *See id.*
[207] *Id.* (internal quotation marks omitted).
[208] *Id.* (internal quotation marks omitted).
[209] *See id.*
[210] *See id.* at 12–13.
[211] *See id.* at 13.
[212] *Id.*
[213] *See id.*

forty-fifth day and its omission of business days clearly and unambiguously required the Optionee to make the payment extension on or before the forty-fifth day after the contract's effective date.[214] According to the court, "[t]he circumstance that the forty-fifth day after the effective date of the contract might fall on a weekend or holiday is a circumstance that is obvious."[215] The court therefore reasoned that the Optionee's claim that a latent ambiguity existed under the circumstances in this case "borders on the nonsensical."[216] The court then noted the fact that the only provision in the contract that referred to business days specifically extended the inspection period "until five business days after the cure or waiver of title defects. The inclusion of that provision demonstrates that the parties were well aware of the difference between 'days' and 'business days.'"[217] The court also found that the Optionee's reliance on purported custom and usage in the real estate industry was unavailing because the parties to such agreements are free to contract as they choose, and the parties often agree to extend the time for performance when the final date for performance falls on a Saturday, Sunday, or holiday. In this case, however, the parties decided not to provide for such an extension.[218] In addition, the contract contained a clear "time is of the essence" provision, and the court found that there was "no reason to believe [this provision] was not intended to apply to the obligation to make payments for extending the option."[219] The court simply refused to "rewrite the agreement of the parties and alter the obligation for timely performance to which [the Optionee] unequivocally agreed."[220]

In *Brick Plaza, Inc. v. Humble Oil & Refining Co.*,[221] the optionee requested that the court allow it to exercise an expired option to purchase land it had leased from the optionor, asserting that the failure to exercise the option to purchase was an honest mistake on its part. The New Jersey Superior Court affirmed the lower court's grant of summary judgment in favor of the optionor because the optionee's delay was not slight and the optionee com-

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[214] *See id.* at 14.

[215] *Id.*

[216] *Id.*

[217] *Id.*

[218] *See id.*

[219] *Id.*

[220] *Id.* The court also approvingly cited an earlier Florida decision, *C.W. Kistler Co. v. Hotel Martinique, Inc.*, 44 So. 2d 288 (Fla. Dist. Ct. App. 1950), which held that "where a stipulated time is mentioned [in an option contract,] it becomes the essence of the contract, which must be performed . . . within the period mentioned." *Id.* at 291.

[221] 526 A.2d 1139 (N.J. Super. Ct. App. Div. 1987).

mitted positive neglect when it did not exercise the option in a timely fashion.[222] The court found that the optionee had so grossly breached its clearly fixed obligations that the court's interest in preserving the stability of business arrangements outweighed whatever equitable purpose may have been served by relieving the optionee from the consequences of its own neglect.[223] The court noted that the delay extended almost five and one-half months beyond the expiration of the three-month period for giving notice.[224] The court stated that "[t]he maxim has long been recognized that equity aids the vigilant, not those who sleep on their rights."[225]

As noted above, many cases of this type—that is, those dealing with whether an optionee exercises an option or related right—are fact-specific, and courts may apply equitable principles to prevent what they deem to be an unjust result. However, considering modern, sophisticated computer programs with automatic tickler and follow-up features, the parties should be vigilant and should strive to meet the option and other deadlines expressed in leases and other real estate contracts.

Nonetheless, courts have not required strict performance in some fact-specific cases. For example, in *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Associates*,[226] the lessee-plaintiff sought to exercise a lease option that allowed for a ninety-nine-year renewal and notified the landlord-defendant of its intention to do so on numerous occasions but without realizing that it had failed to meet all requirements for valid exercise. Despite knowing of the plaintiff's stated intention to exercise the lease option, the court found that the "[d]efendant, through its agents, engaged in a pattern of evasion, sidestepping every request by plaintiff to discuss the option and ignoring plaintiff's repeated written and verbal entreaties to move forward on closing the ninety-nine-year lease."[227]

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[222] *See id.* at 1140–41.

[223] *See id.* at 1141. The court stated that "[c]ases in which equity has intervened to mitigate the hardship resulting from a tenant's failure to give timely notice occur where it is found that the tenant's delay was 'slight,' where it did not prejudice the landlord and where failure to grant relief would cause the tenant unconscionable hardship." *Id.* at 1140. *See also* ARNOLD, *supra* note 29. ("Among other provisions of the first-refusal clause, the manner and form of notice that the landlord is to give to the tenant of a third-party offer should be specified. The time within which the tenant may decide whether or not to meet the offer must be indicated (the time should be sufficient so that the tenant can arrange financing).").

[224] *See id.*

[225] *Id.*

[226] 864 A.2d 387 (N.J. 2005).

[227] *Id.* at 398.

The New Jersey Supreme Court explained that the lessee-defendant's receipt of plaintiff's repeated letters and telephone calls concerning the exercise of the option obliged the lessee-defendant to respond and to respond truthfully.[228] Despite the court's reluctance to interfere in commercial relationships between knowledgeable parties, it found the landlord's subterfuges and evasions so clearly indicative of bad faith that under the circumstances of the case the tenant demonstrated a breach of the covenant of good faith and fair dealing.[229] Thus, the court held that a grant of equitable relief was appropriate because of the lessor-defendant's "demonstrable course of conduct, a series of evasions and delays, that lulled plaintiff into believing it had exercised the lease option properly."[230] The court found that the landlord's overall purpose was to mislead the tenant into losing valuable rights.[231] But the court cautioned that the case was based upon special facts and that it would not find a general duty to warn the tenant of its obligations regarding the exercise of a lease option:

> We are not eager to impose a set of morals on the marketplace. Ordinarily, we are content to let experienced commercial parties fend for themselves and do not seek to "introduce intolerable uncertainty into a carefully structured contractual relationship" by balancing equities. But as our good faith and fair dealing jurisprudence reveals, there are ethical norms that apply even to the harsh and sometimes cutthroat world of commercial transactions. Gamesmanship can be taken too far, as in this case. We do not expect a landlord or even an attorney to act as his brother's keeper in a commercial transaction. We do expect, however, that they will act in good faith and deal fairly with an opposing party. Plaintiff's repeated letters and telephone calls to defendant concerning the exercise of the option and the closing of the ninety-nine-year lease obliged defendant to respond, and to respond truthfully.
>
> In concluding that defendant violated the covenant, we do not establish a new duty for commercial landlords to act

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[228] *See id.* at 399.

[229] *See id.*

[230] *Id.* The case contains a lengthy and comprehensive discussion of what constitutes a breach of the implied covenant of good faith and fair dealing in connection with a commercial lease dispute.

[231] *See id.* at 398–99.

> as calendar clerks for their tenants. We do not propose that attorneys must keep watch over and protect their adversaries from the mishaps and missteps that occur routinely in the practice of law. The breach of the covenant of good faith and fair dealing in this case was not a landlord's failure to cure a tenant's lapse. Instead, the breach was a 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. In the circumstances of this case, defendant's conduct amounted to a clear breach of the implied covenant of good faith and fair dealing.[232]

Similarly, in *Pitkin Seafood, Inc. v. Pitrock Realty Corp.*,[233] the New York Supreme Court, Appellate Division permitted the late exercise of an option when a loss of investment was likely and the optionor was not harmed:

> Even if [the optionee's] initial exercise of the option was not proper, the subsequent attempt by [the assignee of the lessee's interest in the lease] should be given effect. Although it is a settled principle of law that a notice exercising an option is ineffective if not given within the time specified, it is further recognized that a tenant's equitable interest is protected against forfeiture where the tenant has in good faith made improvements, if the landlord has not been harmed by the delay. The Court of Appeals has held that a tenant is equitably entitled to the benefit of the rule which relieves against such forfeitures of valuable lease terms, when default in notice did not prejudice the landlord, and resulted from an honest mistake, or similar excusable default.[234]

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[232] *Id.* at 399 (quoting Brick Plaza, Inc. v. Humble Oil & Refining Co., 526 A.2d 1139, 1141 (N.J. Super. Ct. App. Div. 1987)).

[233] 536 N.Y.S.2d 527 (App. Div. 1989).

[234] *Id.* at 528 (citations omitted); *see also* Paul Roth Trading Co. v. Royal Yarn Dyeing Corp. (*In re* Royal Yarn Dyeing Corp.), 114 B.R. 852, 862 (Bankr. E.D.N.Y. 1990) ("In the instant case, there is ample support on equitable grounds for protecting the Debtor from the forfeiture that would result if it were held to the letter of the lease agreement and the deadline

In *Comerica Bank v. Harbor Northwestern-38000, LLC*,[235] the parties did not dispute that the optionee failed to exercise its option to renew the lease within the time period specified (by April 30, 1999) because the optionee was trying to renegotiate the rent. The tenant did not attempt to exercise the option until June 11, 1999. The court held that the optionor could have refused to renew the lease, and the optionee would have lost all interest in the premises when the lease term ended on October 31, 1999.[236] The optionor instead accepted the optionee's late offer to renew for a five-year term ending October 31, 2004. The court ruled that the parties' rights and obligations during the renewal term were the same as in the original lease, except as otherwise provided. The renewal agreement did not expressly delete or modify the option clause in the original lease, and therefore the optionee acquired another option to renew.[237]

In *Market Street Associates Ltd. Partnership v. Frey*,[238] which arose out of a sale-leaseback transaction, the contract provided that if the lessee wished to improve the property, it must first ask the lessor to provide the needed financing. In particular, the contract contained a provision (paragraph 34) stating that the lessor agreed "to give reasonable consideration to providing the financing of such additional Improvements and Lessor and

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for exercising the renewal option. The testimony taken before this Court and the record is replete with evidence that [the tenant holder of the renewal option] has made substantial improvements to the premises over the life of its tenancy."); Unique Marble & Granite Org. Corp. v. Hamil Stratten Props., LLC, No. 15185/05, 2006 WL 3361537, at *1 (N.Y. Sup. Ct. Oct. 25, 2006) ("The option was timely exercised and signed by the president of the corporate tenant, John Manasakis, who is and remains in possession of the premises. There is no evidence that Manasakis intended to exercise the option in his individual capacity. The failure to change the name of the tenant from John Manasakis to Unique Marble & Granite Org. Corp., as amended by hand on the lease, and the failure to insert the name of the corporation before his signature is an insignificant defect and may be the product of negligence or mistake rather than an attempt to modify or undermine the agreement of the parties."); P.L.I. Dev., Inc. v. Fetterman, 740 N.Y.S.2d 634, 635 (App. Div. 2002) ("Given the plaintiff's large expenditures on the property, the lack of prejudice to the defendants if the option is given effect, and the honest mistake which led to the plaintiff's short delay in exercising its option, equity compels specific performance of the option."); Weissman v. Adler, 590 N.Y.S.2d 241, 243 (App. Div. 1992) (holding that claims by the tenant that he made substantial improvements to property during his tenancy and that he established goodwill during the years he conducted his business at that location, if proven, would entitle the tenant to enforce an option agreement provided that the landlord fails to demonstrate prejudice).

[235] No. 241744, 2003 WL 22851650 (Mich. Ct. App. Dec. 2, 2003).

[236] *See id.* at *1.

[237] *See id.*

[238] 21 F.3d 782 (7th Cir. 1994).

Lessee shall negotiate in good faith concerning the construction of Improvements and the financing by Lessor of such costs and expenses."[239]

If, after negotiations, the lessor declined to provide financing for additional improvements, the lessee could purchase the property at a price determined by a formula specified in paragraph 34. In 1988, the parties negotiated over the financing of improvements on, or a possible sale of, one of the four properties covered by the contract. They did not reach an agreement, and the lessee filed suit for specific performance to force the landlord to sell it the property at a price calculated according to paragraph 34's formula. If the court granted specific performance, the tenant would be able to buy the property at a discounted price because of the appreciation in the property's value during the unexpectedly long time that had run before the tenant asked for the financing.[240] However, the U.S. Court of Appeals for the Seventh Circuit held that because of the tenant's deliberate intention "to deceive the [landlord] through a series of vague and ambiguous letters," the tenant had "violated its duty of good faith [and fair dealing] in performance of the contract."[241]

The Seventh Circuit found that the tenant deliberately failed to bring the matter to the landlord's attention or to make specific mention of paragraph 34 in any of the relevant correspondence and conversations that occurred between the parties in 1988, and that the tenant knew the landlord "was not operating under paragraph 34."[242] The court also found that the tenant "continued to write ambiguous letters, until he wished to utilize the purchase option, thereby purchasing the property at a discounted cost."[243] Thus, the court held that the tenant breached its duty of good faith and fair dealing and "intended to trick the [landlord] by implementing a plan designed to acquire a valuable piece of real property at a price substantially below its market value."[244] Because it found that the tenant breached its duty of good faith and fair dealing in the performance of the contract and took advantage of the landlord's "unilateral, inadvertent mistake" regarding financing opportunities, the court refused to award specific performance to the tenant.[245]

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[239] *Id.* at 784 (internal quotation marks omitted).

[240] *See id.* at 788.

[241] *Id.*

[242] *Id.*

[243] *Id.*

[244] *Id.*

[245] *Id.* at 788. *See generally* George A. Locke, Annotation, *Timeliness of Notice of Exercise of Option to Purchase Realty*, 87 A.L.R.3D 805 (Supp. 2011).

As evidenced by the cases discussed above, the parties to an option or related right and their counsel should be explicit when drafting deadline provisions in such agreements. Stating a specific date (one that is not a Saturday, Sunday, or holiday) may be better than making the deadline expire following a set number of days after the execution of the contract. Alternatively, if the parties clearly intend to require the optionee to exercise the option (or other obligation of a party to a contract) on a business day, then the parties should state this requirement in the option agreement or other contract. Careful and comprehensive drafting of the initial contract language can easily avert the risk of relying on the courts for an equitable result when a party misses a deadline date.[246]

XI. PERFECTING AND ENFORCING A SECURITY INTEREST IN AN OPTION OR RELATED RIGHT

If a person or entity acquires an option to purchase from the owner of a parcel of real estate, is the optionee's interest personal property or real property? If, following the acquisition of an option to purchase, the optionee grants a third-party creditor a security interest in the option, what is the nature of the security interest and what steps must the secured creditor take to assure that the interest is timely and properly perfected to avoid the claims of subsequent purchasers, creditors, and lienholders, including a debtor-in-possession or trustee in bankruptcy? Furthermore, what is the value of the creditor's interest in the option? Does Article 9 of the Uniform Commercial Code (UCC) apply with respect to perfecting the creditor's security interest?

Section 9-109(d)(11) of the UCC provides that (with certain limited exceptions) it does not apply to "the creation or transfer of an interest in or lien on real property."[247] However, if an individual or entity acquires a "naked" option to purchase real estate—that is, an option unrelated to any other existing interest in the real estate, such as a mortgage or lease—a court may deem that the individual or entity has not acquired an interest in the real property that is the subject of the option. At least one

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[246] The holder of the option or related right stating that it intends to exercise the right is usually sufficient. *See, e.g.*, Lakeview Mgmt., Inc. v. Care Realty, LLC, No. 07-cv-303-SM, 2009 WL 903818, at *13 (D.N.H. Mar. 30, 2009) ("While there may well be particular factual circumstances in which use of the phrase 'intends to' would prove inadequate to exercise an option, it is generally accepted that use of the phrase 'intends to' in a notice is sufficient to convey that an option has been exercised."). *See generally* Mark S. Dennison, *Optionee's Timely Exercise of Option to Purchase Realty*, 60 AM. JUR. 3D, *Proof of Facts* § 255 (2001).

[247] UNIF. COMMERCIAL CODE § 9-109(d)(11) (amended 2000), 3 U.L.A. 141 (2010).

court has held that the optionee can only obtain an interest in the real estate when it exercises the option according to its terms. Accordingly, any security interest granted in an unexercised option to purchase would be deemed personalty rather than realty and would be governed by Article 9.[248]

Section 9-102 (a)(42) of the UCC defines a "general intangible" as "any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction."[249] The term also includes payment intangibles—general intangibles under which the account debtor's principal obligation is monetary—and software.[250] In essence, general intangibles is the residual category of personal property that is not included in the other, defined types of collateral. A creditor perfects a security interest in a general intangible (such as the optionee's interest in an option to purchase real estate if deemed to be an interest in personal property) by filing a financing statement in the applicable state's recording office.[251]

On the other hand, under section 9-102(a)(2), the optionor's right to payment under an option to purchase real property would be considered an "account," which the UCC defines as any right to get paid for the sale of any type of property.[252] Article 9 formerly applied only to payment obligations arising out of the sale or lease of goods or the provision of services: "Many categories of rights to payment that were classified as general intangibles under former Article 9 are accounts under this Article. Thus, if they are sold, a financing statement must be filed to perfect the buyer's interest in them."[253] Even though the optionor's right to payment is an account, a court may apply non-UCC law and characterize that right as "an inter-

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[248] *See In re* Merten, 164 B.R. 641, 643 (Bankr. S.D. Cal. 1994); *see also* Gateway Bus. Bank v. The Sequoia Group-Thousand Oaks, LC, No. BC408291, 2011 WL 4544738, at *4 n.8 (Cal. Super. Ct., Apr. 27, 2011) (concurring with holding of the court in *In re Merten* that if option expired under its own terms, debtors would no longer have any rights to which a security interest would attach, rendering the option valueless). *But see* Wachovia Bank v. Lifetime Indus., Inc., 52 Cal. Rptr. 3d 168, 170 n.1 (Ct. App. 2006) ("Although California courts have repeatedly stated that an option to purchase real property does not constitute an interest in real property, there is some authority that an option is nevertheless a mortgageable interest.").

[249] UNIF. COMMERCIAL CODE § 9-102(a)(42) (amended 2000), 3 U.L.A. 58 (2010).

[250] *See id.*

[251] *See id.* §§ 9-310(a), -501(a), 3 U.L.A. 254, 466.

[252] *See id.* § 9-102(a)(2), 3 U.L.A. 53.

[253] *Id.* § 9-102 cmt., 3 U.L.A. 69.

est . . . in real property" that section 9-109(d)(11) excludes from coverage under the UCC.[254]

Under section 9-301(1), creditors make all filings at the location of the debtor.[255] The location of the debtor is determined under section 9-307 and depends on whether the debtor is an individual or an organization.[256] Under section 9-307(b), the general rule is that an individual debtor's location is his personal residence; a debtor organization with only one place of business is located at its place of business; and a debtor organization with more than one place of business is located at its chief executive office.[257] However, under section 9-307(e), a "registered organization" (such as a corporation, limited partnership, or limited liability company), which is formed by filing with a single state that maintains a public record evidencing the organization of the entity, is located in the state under whose laws the debtor was organized.[258]

Under section 9-315(a), a security interest in collateral (such as an option to purchase real estate if deemed to be a personal property interest by a court) continues "notwithstanding sale, lease, license, exchange, or other disposition [of the collateral]," unless the secured party elects to authorize a disposition free of the security interest.[259] A creditor perfects a security interest in proceeds if the creditor properly perfected a security interest in the original collateral.[260] However, if the option subsequently expires by its terms or terminates because of a failure to exercise the option because of default, or by operation of law, then the security interest in the optionee's right to purchase the property would become valueless because the holder

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[254] *Id.* § 9-109(d)(11), 3 U.L.A. 141.

[255] *See id.* § 9-301(1), 3 U.L.A. 214.

[256] *See id.* § 9-307, 3 U.L.A. 239.

[257] *See id.* § 9-307(b), 3 U.L.A. 239.

[258] *Id.* § 9-307(e), 3 U.L.A. 240. Under UCC section 9-307(f), special rules apply if the debtor was organized under the laws of the United States. *See id.* § 9-307(f), 3 U.L.A. 32 (Supp. 2011). UCC section 1-201(28) described an "organization" as follows:

> "Organization" includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity.

Id. § 1-201(28), 1 U.L.A. 158 (2004).

[259] *Id.* § 9-315(a), 3 U.L.A. 289.

[260] *See id.* § 9-315(c), 3 U.L.A. 290. UCC § 9-102(a)(64) expanded the former statutory scope of the meaning of "proceeds" by not limiting the definition to "dispositions." *See id.* § 9-102(a)(64), 3 U.L.A. 61.

of the option would no longer have any legal or property rights to which the interest could attach.

The ability of the holder of a security interest in the optionee's right to purchase real property to retain its security interest in proceeds of the collateral is of special importance if a subsequent bankruptcy proceeding is filed by or against the optionee. If the bankruptcy court permits the debtor-optionee either to sell the option right to a third party or to exercise the option right and then resell the property to a third party (as occurred in the bankruptcy cases hereinafter described), the cash proceeds of the sale would be subject to the secured lender's UCC security interest only if a court deemed the security interest to be an interest in personal property that remained perfected upon the exercise of the option (as opposed to an interest in real property that would require a filing in an office that maintains real estate records).

In *In re Merten*, which was a case of first impression in California on this issue, the bankruptcy court addressed a situation in which the debtors (husband and wife) held two options to purchase, each with different lessors (one option agreement was separate from the lease agreement entered into with the lessor; the other was contained in the lease with that lessor), and exercised both options after filing a Chapter 11 bankruptcy petition.[261] The debtors had granted a creditor, Imperial-Yuma Production Association (IPA), a pre-petition security interest in all of their contract rights and general intangibles. IPA had perfected its security interest pre-petition by filing a UCC financing statement with the California Secretary of State's office. IPA held deeds of trust on certain lands held by the debtors but not on the property that was subject to either of the lease options.

The court ruled that under applicable California law, a security interest in an unexercised option by the debtor to acquire real estate is a general intangible subject to the UCC.[262] The court noted that "'general intangibles' for purposes of secured transactions include contract rights and rights to performance," and that a security interest in an unexercised option is personalty rather than realty.[263] The court also held that because IPA had properly filed a pre-petition UCC financing statement respecting its interest in the option, it had obtained a perfected security interest in the unexercised option right.[264] However, the court permitted the debtors to exercise their

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[261] *See In re Merten*, 164 B.R. 641, 642 (S.D. Cal. 1994).

[262] *See id.* at 643.

[263] *Id.*

[264] *See id.*

options to purchase the respective properties post-petition and held that the exercise of the option divested the creditor of any security interest it had in the collateral under the UCC because the option rights no longer existed.[265]

The court also held that the exercise of an option to purchase real estate converts the transaction into "a sale or a bilateral executory contract of purchase and sale, whereby the optionee acquires an equitable interest in the land."[266] Therefore, the court ruled that because a sale had occurred pursuant to which the holder of the options acquired an actual interest in the real property (that is, equitable title) that was the subject of each of the options, the sale abrogated whatever security interest IPA may have had in the option rights and transferred it to the real estate.[267] However, because the creditor did not properly record and perfect its transferred interest, which was now exclusively an interest in real estate (and therefore came within the meaning of the terms "conveyance" and "transfer" as used in the California statute governing recordation), the court further held that IPA's security interest was not enforceable under the "strong arm" provisions of section 544 of the Bankruptcy Code against the debtor in possession (or a bankruptcy trustee) or against subsequent purchasers or creditors without notice.[268] The court, having authorized the debtors to exercise the options, also authorized them to resell the properties through a double escrow to a third party free and clear of IPA's security interest.[269] The court rejected IPA's motion to compel turnover of the proceeds from the debtors' sale of the properties (proceeds that the debtors had segregated in a "blocked" account), in which IPA argued that its security interest in the option contract rights should have survived the sale and attached to the proceeds.[270]

At least one bankruptcy court has held that an option to purchase contained in a lease agreement is an interest in real estate and is not subject to the UCC. In *First National Bank of Chicago v. Valley Liquors, Inc.* (*In re Valley Liquors*),[271] the defendant-debtor held an option to purchase the property that it leased for the operation of a liquor store (the debtor entered into the lease before it filed its bankruptcy petition). The debtor subsequent-

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[265] *See id.* As the court eloquently stated, "[o]n proper and timely acceptance or exercise, an option as such becomes '*functus officio*' and ceases to be a mere option." *Id.*

[266] *Id.*

[267] *See id.*

[268] *See id.*

[269] *See id.* at 642.

[270] *See id.* at 641–43.

[271] 103 B.R. 961 (Bankr. N.D. Ill. 1989).

ly obtained a bankruptcy court order authorizing it to sell the option right to a third party for $140,000.[272] The order authorized the sale free and clear of all liens, claims, and encumbrances that attached to the proceeds of the sale.[273] The plaintiff, First National Bank of Chicago (Bank), alleged that it had a valid security interest in the option—and therefore also in the proceeds of the sale of the option—by its prior filing with the Illinois Secretary of State's office of financing statements in connection with a revolving line-of-credit loan to the debtor.[274] The financing statements covered the debtor's interest in, among other things, general intangibles. The bankruptcy trustee argued that the Bank had failed to properly perfect a security interest in the option right.

The bankruptcy court first noted that under the UCC, as adopted in Illinois, "[a]n interest in real estate . . . is not a general intangible, because it is not personal property and is expressly excluded from application of the Uniform Commercial Code."[275] The court agreed with the trustee's argument that even if the debtor had not exercised the leasehold option, the option still was an interest in real estate and not a general intangible under the UCC.[276]

The court ruled that under Illinois law an interest in a leasehold option is realty rather than personalty and must be filed with the Recorder of Deeds rather than as a UCC filing with the Secretary of State's office.[277] The court stated that "just as the rents flowing under a lease cannot be U.C.C. Article 9 collateral for a loan, neither can a leasehold option to purchase realty be collateral under Article 9."[278] The court further held that even if the lender had properly recorded a UCC interest in the option and thereby obtained an otherwise perfected security interest in personalty, that interest was ineffective once the lender exercised the option and the secured property changed into realty.[279] The court also stated the following: "[O]nce the Option involved here was exercised, it ripened into a contract for Debtor to purchase real estate. As such it was clearly not covered by the Uniform Commercial Code at that time."[280] The court ruled that to preserve its security interest in

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[272] *See id.* at 964.
[273] *See id.*
[274] *See id.* at 965.
[275] *Id.*
[276] *See id.* at 966.
[277] *See id.*
[278] *Id.*
[279] *See id.* at 971.
[280] *Id.* at 968.

the option, the Bank would have had to record its interest with the county recorder.[281]

The decisions in *In re Merten* and *In re Valley Liquors, Inc.* provide important lessons for parties wishing to obtain enforceable security interests in options to purchase real estate. Although both of these cases were decided before the revisions to UCC Article 9 in 2001, the same considerations regarding the perfection and enforcement of a security interest in an option to purchase real estate apply. A creditor that obtains a security interest in an optionee's right to purchase real estate should take steps to perfect its security interest in the option by not only filing a UCC financing statement with the secretary of state's office in the jurisdiction in which the debtor is located (to comply with UCC Article 9), but also by recording simultaneously an instrument with the county recorder's office evidencing its security interest in the real property to which the option or related right relates.[282] Whether an unexecuted option is real property for purposes of section 9-109(d)(11)—which provides that Article 9 does not apply to "the creation or transfer of an interest in or lien on real property"—is still unclear.[283] Only future litigation on a case-by-case basis is likely to resolve this issue. A legislative solution, on a state-by-state basis, may be the most appropriate way to bring a degree of certainty and predictability to the legal rights and obligations of holders of options to purchase real estate, as well as to creditors who wish to obtain and perfect a security interest in such option rights.[284] However, there has been no movement in this direction.

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[281] *See id.*

[282] *See*, *e.g.*, Steven O. Weise, *U.C.C. Article 9: Personal Property Secured Transactions*, 50 BUS. LAW. 1553, 1554 (1995)("It seems that the option to acquire the property is so related to the property that real property law ought to govern an interest in the option. The secured party should have had the debtor record the option and then should have recorded a deed of trust or mortgage against that interest."); s*ee also In re Valley Liquors,* 103 B.R. at 970 ("[T]he party can record its [option] interest with the County Recorder. Therefore, to be safe [the Bank] could have double recorded, both with the Recorder of Deeds and the Secretary of State"); John C. Murray, *Synthetic Leases: "Bankruptcy Proofing" the Lessee's Option to Purchase*, 106 COM. L.J. 221, 229 (2001) (discussing issue of whether option to purchase contained in lease may be unenforceable if bankruptcy proceeding is subsequently filed by or against lessor and bankruptcy trustee elects to reject lease).

[283] UNIF. COMMERCIAL CODE § 9-109(d)(11) (amended 2000), 3 U.L.A. 141 (2010).

[284] Section 9-109(d)(11) of the UCC is inapplicable to "the creation or transfer of an interest in or lien on real property," and this exclusionary language may include (at least in Illinois, pursuant to *In re Valley Liquors, Inc.*), an unexercised option to purchase real estate. UNIF. COMMERCIAL CODE § 9-109(d)(11), 3 U.L.A. 141.

For example, in the mid-1990s, a subcommittee of the Chicago Bar Association's Real Property Law Committee proposed the enactment by the Illinois legislature of the Recordable Option Act (Proposed Act) drafted by certain Committee members, which would apply only to commercial real property. The Proposed Act provided that an option to purchase real estate, a memorandum of the option, or any renewal or extension of the option would be valid from the time of the option agreement's recording against subsequent purchasers and creditors—so far as it would affect real estate—as if it were a deed conveying the estate or the interest embraced therein. Therefore, a recorded option to purchase real property (or a memorandum thereof) would clearly constitute an interest in real estate, and not an interest in personal property, as of the date of recordation. The Proposed Act further provided that a recorded option would no longer constitute actual or constructive notice to any party nor put any party on notice as to the existence or exercise of the option if all of the following occurred: (1) the option expired in accordance with its terms; (2) one year had elapsed since the expiration date; and (3) no one had recorded an instrument showing exercise of the option. The Proposed Act would take effect immediately upon becoming law. Unfortunately, the Proposed Act never garnered enough momentum or support to have a realistic chance of passage, and there have been no efforts to revive it.

XII. CONCLUSION

As evidenced by the cases and statutory law discussed in this article, the careful and comprehensive drafting of documents that describe contractual options and related rights is critical to clearly expressing the intention of the parties regarding the scope of the rights granted and to avoiding unintended and undesirable consequences. It is especially important to address specifically any desired carveouts from coverage under a right of first refusal—for example, condemnation or sale to a governmental entity; portfolio or package sales that include other properties along with the property subject to the right of first refusal; sales or transfers of equity interests in entities owning the property (including stock transfers and transfers between tenants in common) that would effectively constitute a sale of the property; foreclosures or deeds in lieu of foreclosure; gifts and donations; certain indirect transfers of the property or the equity interest therein; sales or transfers by individuals to family members or into estate-planning trusts or LLCs, transfers of partnership or LLC interests in family-owned partnerships, or transfers of LLCs to individual family members; and sales involving exchanges of real estate or exchange of the property or other types of exchanges for

noncash consideration.[285] The parties must specifically and comprehensively draft each of these carveouts to address the clear intentions. As this article illustrates, clauses regarding options to purchase and related rights contained in leases, purchase agreements, and other legal documents are complex and require a great deal of attention from counsel regarding both the business terms and the legal aspects and consequences.[286]

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[285] In the case of a tax-free exchange under section 1031 of the Internal Revenue Code or other noncash consideration (such as unique personal property) for the sale, transfer, or exchange of the property in connection with a right of first refusal, what if nothing is said to cover such a situation? From a drafting standpoint, it may be wise to either expressly exclude any such transaction from the right of first refusal altogether or provide a valuation mechanism, perhaps enforceable by arbitration if the parties are unable to agree upon the value of the consideration within a specified period of time, whereby the holder of the right would have the ability to pay the consideration, as so determined, in cash. *See also Structuring an Option with a 1031 Exchange*, FIRST AMERICAN EXCHANGE COMPANY, http://firstexchange.com/December 2011Newsletter (noting that there is not much authority dealing with the tax treatment of options or similar rights in connection with section 1031 exchanges and stating that "issues to consider are whether options are like kind only to other options or whether they can be considered like kind to a fee interest in real estate, and whether granting an option can make the relinquished property be treated as property held for sale rather than held for investment purposes").

[286] For example, "clogging" issues (which are beyond the scope of this article) may arise in connection with "convertible" mortgages. The clogging doctrine invalidates any provision that may prevent the mortgagor from redeeming and retaining ownership of the mortgaged property by paying the indebtedness in full prior to entry of a valid foreclosure decree, as well as any provision that grants the mortgagee a "collateral advantage." *See* Murray, *supra* note 187 at 280. Convertible mortgages are mortgages in which the mortgagee has an option to purchase the mortgaged property at some future time (either on or before the maturity date of the loan) for either a fixed purchase price or the fair market value of the property at the time the option is exercised. The option may arise as the result of a default by the mortgagor, upon the occurrence of a specified event, or at the expiration of a stated time period. Several courts have held that the option feature of a convertible mortgage is unenforceable as a clog on the equity of redemption. *See id.* at 282–88 (containing an in-depth analysis of clogging issues in connection with convertible mortgages and a compilation and discussion of case law in this area); Joyce D. Palomar, *Title Risks in Foreclosure Proceedings – Mortgagors' Defenses*, *in* 3 LAW OF DISTRESSED REAL ESTATE § 42:25 (2011) ("A convertible mortgage gives the mortgagee an option to purchase the mortgaged property in the future. In states where statutes have not settled this issue, a mortgagor might challenge the enforceability of the option clause on the grounds that it clogs the mortgagor's equity of redemption or that it should be recharacterized as giving the mortgagee additional security rather than a right to a fee simple absolute."); *see also* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. d (1996) ("Courts occasionally use the clogging concept to deny specific performance of an option to purchase the mortgaged real estate granted to a mortgagee incident to a mortgage transaction. Such an option can be viewed as a clog on the equity of redemption because it allows a mortgagee to acquire the real estate by means other than foreclosure. To the extent that the option is enforced it renders the land irredeemable.").

APPENDIX A

"PROS AND CONS" CHART

TYPE OF RIGHT TO BUY PROPERTY OR TO LEASE SPACE	PROS	CONS
Option	• Optionee controls timing of exercise of right • Rent or purchase price is set in advance	• Owner may be reluctant to give option • Optionee may have to pay additional consideration for the right
Right of First Refusal	• Owner must sell or lease the space on same terms it's willing to accept from a third party	• Owner controls timing of exercise of right • Rent or purchase price isn't set in advance • Owner may be reluctant to give this type of right without additional consideration • May "chill" offers from third parties
Right of First Negotiation	• Owner may be more willing to grant this type of right • Holder of right gets first opportunity to negotiate a deal for the space before it goes on the market	• No guarantee that holder of right will reach a final agreement with owner for the space
Right of First Offer	• Owner may be more willing to grant this type of right • Holder of right gets to make first offer for the space before it goes on the market • Bars owner from accepting a purchase price from a third party that is less than what holder of right offered (or a certain percentage thereof)	• Holder of right is forced to make offer in a vacuum—that is, without knowing owner's estimate of space's value

APPENDIX B
RIGHT OF FIRST REFUSAL

_____ and _____ (hereafter "Grantors"), in consideration of the payment of _____ Thousand Dollars ($__,000.00), the receipt and sufficiency of which are hereby acknowledged, hereby grant to _____ and _____ _____ (hereafter "Grantees"), a right of first refusal to purchase the premises described in **Schedule A** attached hereto, upon the terms and conditions herein set forth:

Grantors grant to Grantees a right of first refusal, for the period set forth below (referred to hereafter as the "Duration"), to purchase the premises described in **Schedule A** on such terms and conditions as Grantors would be willing to sell said premises to a third party.

At such time as Grantors, at any time during the Duration, receive a written offer to purchase said premises that they wish to accept (the "Offer"), they shall notify Grantees of such receipt and shall include in such notice a true and accurate copy of the Offer as submitted in writing to Grantors. Grantees shall then have eight (8) days, excluding Saturdays, Sundays and state or federal holidays, from delivery of such notice in the manner set forth below, within which to enter into a written agreement of sale and purchase with Grantors upon the same terms and conditions as are contained in the Offer, including any and all contingencies therein for such matters as, e.g., inspections, obtaining mortgage financing, zoning matters, or the like.

All dates set forth in the Offer shall be adjusted to account for the delay between the Grantors' delivery of notice of the Offer and Grantees' entering into a written agreement of sale and purchase with Grantors upon the same terms and conditions as are contained in the Offer. (For example: If the Offer is dated March 1st and sets forth a closing date of May 15th, and notice of the Offer is delivered to Grantees on March 6th and Grantees exercise their right of first refusal on March 12th, Grantees' agreement with Grantors shall be considered to be "upon the same terms and conditions as are contained in the Offer" if it sets forth a closing date of May 27th. Dates such as dates for earnest money deposits, inspection contingencies, and the like shall be similarly adjusted.) Grantees shall be deemed to have "entered into a written agreement of sale and purchase with Grantors" upon Grantees' timely delivery to Grantors of a writing signed by Grantees upon the same terms and conditions as are contained in the Offer; the failure, neglect or refusal of Grantors or either of them to sign such timely delivered "written agreement of sale and purchase with Grantors" shall not defeat Grantees' exercise of the right of first refusal hereunder.

If Grantees do not so enter into such agreement, then this right of first refusal shall be null and void. Grantees agree to execute any and all documents that Grantors may request to waive or release the right of first refusal not so exercised. Grantees shall be liable to Grantors for all costs incurred by Grantors, including attorney's fees, in the event of Grantees' wrongful failure to so waive or release this right of first refusal.

Any notices required hereunder may be sent by the U.S. mails, first class, postage prepaid, certified, return receipt requested, addressed as follows:

TO GRANTORS:

_____

_____

TO GRANTEES:

_____

_____

or to such other address as may be designated in a writing sent by one party to the other at the foregoing address. Delivery by overnight courier and service by state marshal are also acceptable methods of delivery of notices hereunder. Notice(s) shall be deemed received or delivered when physically delivered to the address(es) as set forth herein (as may be changed by written notice aforesaid). Notice to one of the Grantees or to one of the Grantors shall not be deemed notice to both Grantees or both Grantors. Nothing in this paragraph regarding notices shall be deemed to prohibit there being different addresses to which notices must be sent for each of the Grantees or for each of the Grantors.

This right of first refusal shall be and remain in effect from the date the same is executed by the Grantors until the date that is twenty (20) years after the date of death of the survivor of the Grantors.

This right of first refusal: (1) is not assignable by Grantees, except that each may assign it to the other; (2) shall not survive the deaths of both of the Grantees, or, if assigned by one Grantee to the other, the death of the assignee; (3) shall terminate upon the filing of a petition in bankruptcy by or against Grantees or either of them; and (4) is not exercisable by only one of the Grantees if such one Grantee has not had the right of first refusal assigned to him or her by the other Grantee.

Any assignment as permitted by the terms hereof shall not be effective unless and until notice thereof has been delivered to Grantors in the manner specified herein for the delivery of notices.

This right of first refusal is binding upon the heirs, successors and assigns of Grantors.

Executed this ____ day of _____, 20__.

GRANTORS:

_____

_____

GRANTEES:

_____

_____

Witnesses:

_____

_____

STATE OF _____)
) ss.
COUNTY OF _____)

On this the _____ day of _____, 20__, personally appeared, before me, the undersigned officers, _____ and _____, signers and sealers of the foregoing instrument, who acknowledged that they executed the same for the purposes therein contained as their free act and deed.

_____
Notary Public
My commission expires:

SCHEDULE A
to a Right of First Refusal

APPENDIX C

TENANT'S RIGHT OF FIRST REFUSAL

a. Right of First Refusal. Provided that Tenant:
(i) Is not in default under this Lease,
(ii) Has not assigned this Lease or sublet all or part of the Premises, or
(iii) Is not holding over in the Premises,
if Landlord enters into a contract to sell its entire fee interest in the Premises (and only the Premises) (a "Sale"), Tenant shall have a one-time right of first refusal to purchase of the entire Premises ("Refusal Right"). In the event of a Sale, Landlord shall notify Tenant in writing of the prospective Sale of the Premises ("Landlord's Notice"). Landlord's Notice shall include the elements of the business deal of such prospective Sale (the "Elements"), and a contract of sale executed by Landlord containing the material terms of the Sale (the "Contract of Sale") for Tenant's signature.

b. Tenant's Exercise of Right. In order to exercise the Refusal Right, Tenant shall:
(i) Accept the terms of the Sale as set out in the Contract of Sale by notifying Landlord, in writing, sent by registered or certified mail, return receipt requested, of its intent to so accept, postmarked within five (5) business days after receipt of Landlord's Notice; and
(ii) Execute and return to Landlord the Contract of Sale within fifteen (15) days after receipt of same from Landlord.

c. Proof of Financing. If Tenant shall timely exercise the Refusal Right, Tenant shall, within five (5) days following its execution of the Contract of Sale, provide Landlord with evidence of a non-contingent financing commitment or other evidence acceptable to Landlord, in Landlord's sole and absolute discretion, of Tenant's ability to close on or before the closing date set forth in the Contract of Sale. If Tenant has not shown Landlord such evidence within the five (5) day period, Landlord shall have no obligation to sell the Premises to Tenant and Tenant's rights under this clause shall forever be null and void.

d. Closing. Following Landlord's receipt of satisfactory evidence from Tenant of Tenant's ability to close pursuant to the terms of the Contract of Sale, Landlord and Tenant shall proceed to close the sale of the Premises no later than the closing date set forth in the Contract of Sale.

e. Lapse of Refusal Right. If Tenant shall fail to timely perform any of its obligations as set forth herein, or if Tenant shall opt not to exercise the Refusal Right, the Refusal Right shall lapse and Landlord shall be free to sell the Premises

pursuant to the Elements or any subsequent agreement for the transfer of the Premises.

f. No Assignment of Right. The Refusal Right is personal to Tenant and may not be assigned by Tenant in connection with an assignment of this Lease or otherwise. The Refusal Right may not be exercised by anyone other than Tenant. Any attempted assignment of the Refusal Right shall be of no effect and the Refusal Right shall become forever null and void as of the date of the purported assignment.

g. Events Not Triggering Refusal Right. Anything contained herein to the contrary notwithstanding, in the event of any of the following, the Refusal Right shall be deemed not to have arisen and of no force and effect:
(i) The sale of the Premises to an Affiliate (as defined in Clause _____ hereof) of Landlord or to a government entity;
(ii) The sale of the Premises in connection with a sale of all or substantially all of Landlord's assets or shares (or interests);
(iii) Landlord's shares becoming or continuing to be traded on the New York, or Over-the-Counter stock exchange or market or any similar exchange or market;
(iv) The entering into of any management agreement or any similar agreement which transfers control of the Premises by Landlord;
(v) The entering into by Landlord of any ground lease, mortgage, or trust deed upon all or any portion of the Premises, any advances made thereunder and all renewals, modifications, consolidations, replacements, extensions, and re-financings thereof; or
(vi) The entering into a contract by Landlord for the sale of more than one property wherein the Premises is one of such properties.

h. Subordination. The Refusal Right shall be subject and subordinate to any mortgage now or hereafter placed upon the Premises or any portion of the [Building/Center], and to any renewals, modifications, consolidations, replacements, extensions, and re-financings thereof. Tenant agrees to execute and deliver whatever instruments may be requested by any Lender for such purposes. If Tenant fails to do so within ten (10) days after demand in writing, Tenant does hereby make, constitute, and irrevocably appoint Landlord as its attorney-in-fact (which shall be deemed to be coupled with an interest) and in its name and place to execute and deliver such instruments.

APPENDIX D

RIGHT OF REFUSAL/RIGHT-TO-OFFER AGREEMENT

THIS AGREEMENT (the "Agreement") is made effective the __ day of _____ 20___, by _____ and _____, husband and wife, having a notice address at _____ (the "Owners") in favor of _____, a _____ corporation (the "Developer"), having a notice address at _____.

RECITALS:

A. The Owners own approximately _____ (_____) acres of real property in _____, _____County, (the "Land"), more particularly described as follows:

(Insert Legal Description)

B. The Developer is interested in determining whether the Land can be subdivided and developed;
C. The Developer's interest is contingent on the Developer gaining access to the Land to conduct feasibility studies, inspections and tests;
D. If the Developer determines that it is feasible to subdivide and develop the Land, the Developer intends to enter into negotiations with the Owners to purchase the Land on terms that are mutually satisfactory to the Owners and the Developer; and
E. The Owners are willing to grant such access to the Developer on the terms hereinafter provided, but not otherwise.

AGREEMENTS:

In consideration of the payment to the Owners of One Hundred Dollars ($100.00) and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Owners and the Developer agree as follows:

[1. Right of Refusal. If during the term of this Agreement the Owners receive a bona-fide third-party offer (the "Offer") to purchase all or any part of the Land on terms that are acceptable to the Owners in the Owners' sole discretion, within five (5) business days after the Owners' receipt of the Offer the Owners agree to notify the Developer in writing (the "Notice") by certified mail of the terms of the Offer. The Developer will have thirty (30) days after the date of receipt of the Notice within which to notify the Owners that the Developer elects to purchase the Land (or the portion thereof which is the subject of the Offer) on the terms of the Offer as described in the Notice. If the Developer so elects, the closing of such sale will take place at the offices of _____ Title Company, _____, pursuant to the terms of the Offer. If the Developer does not elect to purchase the Land (or the portion thereof that is the subject of the Offer) within thirty (30) days after the date of the Developer's receipt of the Notice, the Owners may sell or transfer the Land (or the portion there of which is the subject of the Offer) to another purchaser at the price and on substantially the terms stated in the Offer. As used herein, the word "purchase"

will be deemed to include any transaction whereby the Owners contribute all or any portion of the Land, or the Owners' beneficial interest therein, to a partnership, corporation, limited liability company, trust or other entity, in exchange for an interest in such entity.]

[1. Right to Offer. Before the Owners may sell or transfer the Land to any third party, the Owners agree to first offer the Land to the Developer by giving written notice (the "Owners' Offer'" 9 of the terms and conditions on which the Owners are willing to sell the Land. The Developer will have thirty (30) days after the date of receipt of the Owners' Offer within which to notify the Owners that the Developer accepts the Owners' Offer on the terms and conditions therein contained. If the Developer accepts the Owner's Offer, the closing of such sale to the Developer will take place at the offices of Title Company, _____, _____, pursuant to the terms of the Owners' Offer. If the Developer does not accept the Owners' Offer in writing within thirty (30) days after the date of the Developer's receipt thereof the Owners may sell the Land to any other person at the price and on the terms and conditions stated in the Owners' Offer within one hundred twenty (120) days after the date of the Owners' Offer. At the end of such one hundred twenty (120) days, the right of the Owners to sell the Land free from the right of refusal hereby granted will terminate, and the provisions of this Agreement will apply to any subsequent proposed sale or transfer of the land by the Owners. The right of refusal hereby granted will expire on the date that is twenty-one (21) years after the death of the last surviving child of , unless sooner terminated by the exercise of or failure to exercise the option set forth herein. As used herein, the word "sell" will be deemed to include any transaction whereby the Owners contribute all or any portion of the Land, or the Owners' beneficial interest therein, to a partnership, corporation, limited liability company, trust or other entity, in exchange for an interest in such entity.]

1. Term. This Agreement and the rights herein granted will expire at midnight on the one hundred eightieth (180th) day after the date of execution of this Agreement by all parties.

2. Right of Entry. During the term of this Agreement, the Developer, the Developer's agents, employees, independent contractors and engineers will have the right from time to time to enter on the Land at the Developer's sole risk for the purpose of inspecting the same and conducting surveys, engineering studies, borings, soils tests, environmental studies, investigations, feasibility studies and such other studies, tests and inspections as the Developer deems appropriate. All such entries will be made in such a manner as to minimize any material interference with the Owners' use of the Land. The Developer, to the Owners' reasonable satisfaction, will restore the Land as nearly as possible to the condition immediately preceding any exercise by the Developer of the right of entry and inspection granted to Developer pursuant to this Agreement. The Developer agrees to indemnify, defend and hold the Owners harmless from all liability or claims of liability directly or indirectly arising out of any such entry; which indemnification obligation will survive the termination of this Agreement.

3. Application for Approvals. During the term of this Agreement, the Developer will have the right, but not the Obligation, to apply to appropriate authorities for and to prosecute the obtaining of: (a) agreements for all improvements required by governmental authorities as a condition to the development of the Land; (b) any variances, special exceptions, uses or other approvals required under zoning or other laws, regulations or requirements pertaining to the intended use, occupancy or development of the Land; and (c) all other permits and approvals which, in the exercise of Developer's reasonable judgment, are required as a prerequisite to the development of the Land.

4. Owners' Participation. During the term of this Agreement, the Owners, at the Developer's expense, agree to join in the execution of such applications and other documents and participate, to the extent not overly burdensome to the Owners, in such proceedings, as are, in the exercise of the Developer's reasonable judgment, required to determine the feasibility of the Land for the use intended by the Developer; provided, however, the Owners will not be required to join or participate in any of the foregoing if to do so would result in any liability or financial obligation being imposed on the Owners or the Land unless the Developer agrees to bear the same. The Developer agrees to indemnify, defend and hold the Owners harmless from any such obligation or liability, which indemnification obligation will survive the termination of this Agreement.
5. Binding Effect. This Agreement will inure to the benefit of and bind the respective heirs, personal representatives, successors and assigns of the parties.
6. Entire Agreement. This instrument constitutes the entire agreement between the parties relating to the subject matter of this Agreement and there are no agreements, understandings, warranties or representations between the parties except as set forth herein.
7. Attorneys' Fees. If either party institutes an action against the other party relating to the provisions of this Agreement or any default hereunder, the unsuccessful party to such action will reimburse the successful party for the reasonable attorneys' fees, disbursements and other litigation expenses incurred by the successful party.
8. Irrevocable. The rights granted to the Developer will be irrevocable during the term of this Agreement.

IN WITNESS WHEREOF, the undersigned have executed this instrument this _____ day of ____, 20__, effective the date first above written.

_____

_____
(the "Owners")

_____, a _____ corporation

By: _____
President
ATTEST:(the "Developer")
_____
(SEAL)
Secretary

ACKNOWLEDGMENTS

[INSERT APPROPRIATE ACKNOWLEDGMENTS]