

RIGHTS OF FIRST REFUSAL, RIGHTS OF FIRST OFFER, AND PURCHASE OPTIONS

By Jim Hochman, and David Liebman, SIOR

When negotiating a lease or contract, a complete understanding of your client's objectives, coupled with careful drafting and review of these clauses, is essential. We offer a few suggestions in the negotiation process in the hope that you can minimize, if not prevent, misunderstandings or misinterpretations of these clauses when these important rights are exercised. Also, there may be a way to make these clauses most palatable to one party when they typically benefit the other party.

Rights of First Refusal (ROFR)

Simply defined, this is the right, typically extended by the: (i) landlord to the tenant in the lease; or (ii) owner of property to a prospective purchaser; or (iii) one co-investor to another co-investor, if a third-party bona fide offer to buy an interest in property is received. If exercised, the right holder can match the terms of the bona fide offer the Lessor or Seller would accept or pass on the deal. The more significant the transaction contemplated by the right (e.g., an investor buying a major industrial or office property v. a tenant expanding into adjacent, unoccupied space), the longer the period usually allowed for the right to be exercised. The manner in which the notice of the offer is transmitted and the manner for the ROFR holder's response to be exercised must be clearly and succinctly stated. Technology today has created multiple ways, subject to regulation and case law in each state, by which the parties can effect "legal and effective notice," so be sure to consider those concepts when negotiating these clauses.

In a lease, a ROFR typically hampers a landlord's ability to freely lease vacant space in or sell a property to a third

party, as the right holder holds the cards and delays the third party's success in acquiring the property. Be sure to assess and determine up front, as the deal is negotiated, your respective client's real objectives for putting the ROFR in the lease or contract, as this will inform both parties as to the propriety and likelihood of the ROFR making its way into the final lease or contract.

Right of First Offer (ROFO)

Also referred to as the right of first opportunity or first right to lease or purchase, the owner/landlord gives the right or the first chance to buy or lease property when the property becomes available. Note that unlike the option to purchase below, the holder cannot force the owner to sell the property. ROFO's are preferred by landlords in that they control the property by requiring the right holder to respond to landlord-proposed price and terms. There are some industrial landlords of larger properties and units who are very careful to control the pricing, terms and ultimate outcomes under any ROFO (and typically require that the ROFO is a one-time right rather than a continuing right) that they grant to big box tenants, to prevent leasing space below current market rates. In reality, a ROFO merely

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reflects what a landlord or seller would likely do anyway, i.e. offer the space or property to a party which is already in possession or has exercised interest in the property. Landlords and Sellers usually offer a ROFO, where Buyers and Tenants prefer a ROFR.

If either the ROFR or ROFO is exercised, what happens next? Does the securing party deposit money? Does the landlord draft a lease amendment and send it to the tenant? If so, how long can the tenant take to review and finally sign the lease amendment? Is either party obligated to make certain representations or warranties about the property upon exercise of the ROFR or ROFO? Who pays the brokerage commissions and to whom? Are commissions paid upon exercise OR delayed until the amendment or confirming document is fully executed? Again, be a demon for details, your clients will appreciate the efforts taken to protect them from ambiguity.

Purchase Options

Here, the right holder has the option to purchase a defined property during the term of the option, regardless of the owner's desire to sell. When negotiating these rights in a lease or contract, language becomes critical to properly

reflect the intent and mechanics that take place when the purchase option is exercised, so that option can't be challenged by a reluctant owner/seller. Here, the option holder *can* compel the owner to sell the property. These options must be specific as to price, terms, manner and mechanics of exercising the option. The simplest way to prevent discord at time of option exercise is to pre-negotiate and attach the purchase and sale contract as an exhibit to the lease or option agreement.

As a final word of caution, be sure to enlist the help of qualified, experienced legal counsel to properly draft these three clauses and supporting documents. For example, in one reported case, a purported "first right of refusal on the property" was construed by the trial court to be an option to purchase, but that ruling was overturned on appeal. The glitch was created by ambiguous language in the lease that incorporated elements of both a right of first refusal and an option to purchase. Had the parties drafted the documents more appropriately, costly and protracted litigation would have been prevented. More important, if the document had been drafted more clearly, there would have been a successful transaction instead of a lawsuit. ♥

ABOUT THE AUTHORS



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