

RIGHTS OF FIRST REFUSAL - TIPS AND TRAPS

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A right of first refusal is a common provision in commercial leases. The ROFR may give a tenant the right to lease additional space in a building or allow a tenant to purchase the entire property in the event a bona fide offer is received for a potential sale. A ROFR is really an option contract that binds the landlord to lease or sell to the counter party on the same terms and conditions contained in an offer from a third party. Since it is an option, the acceptance of the offer must comply with the terms of the offer. A ROFR often leads to trouble for property managers and this article will discuss ways to manage leases where a ROFR is present.

A ROFR is different from a Right of First Offer which requires the owner before offering the property to a third party to offer the property to the tenant on the terms that will be contained in the offer. Typically, a tenant will ask for a ROFR to protect expansion space in a building or to acquire the right to purchase the building usually when the tenant is single user. Under a ROFR, the owner of the property contractually agrees in advance that if, in the future, there is to be a transaction covered by the ROFR that the holder of the ROFR has the first right to accept or reject any such offer.

As a property manager, you typically do not have input into the terms of the ROFR. For instance, the ROFR may provide that while the material terms of the third party offer must be accepted there are ancillary terms that are left open for negotiation. On the other hand, these ancillary terms may be set out in the ROFR itself. A common question for property managers is when are you required to notify the holder of the ROFR? We have had issues where leases were signed with third parties before the leasing agents realized that a current tenant had a ROFR for all or part of the leased space. This typically leads to litigation.

However, even when the owner or leasing agent is aware of the ROFR there are issues as to when the property manager is required to or should notify the holder of the ROFR. Is it at the time of the non-binding letter of intent or is it when there is a fully executed lease that is hopefully made subject to the ROFR? If you send out the executed non-binding letter of intent you may have a situation where there are numerous terms that have not been addressed and may be heading for a lengthy negotiation unless the ROFR specifically limits the amount of time the holder has to agree to a lease, amendment or purchase agreement. If you send a fully negotiated lease this commits the holder to either accept the negotiated terms or pass on the option. This is a strategic decision that you should discuss with your owner and the attorney representing you and the owner.

You also need to be sure that you are on top of the time periods applicable to the ROFR. There are calendar days and business days as well as national holidays. As a property manager you should be very careful to diary the dates so that proper and timely notices can be either sent or monitored.

Many ROFR's are conditioned on the tenant not having committed an event of default during the term of the lease. It is important to review this language carefully since if there was a default that was cured and the language speaks in terms of not having committed an event of default versus being in default at the time of the ROFR's effectiveness the tenant may have waived its rights under the ROFR.

Additionally, many ROFRs are limited to the actual tenant and not any subtenant or assignee of the lease. If there has been an assignment, care must be taken to evaluate the type of assignment, such as to a parent or an acquisition, and the language of the limiting language in the ROFR.

If litigation commences over a ROFR the case will typically proceed as a breach of contract case. If the lease containing the ROFR has a limitation of damages provision such as a limitation on the award of consequential damages including lost profits there are damage issues for the holder of the ROFR. The typical measure of damages is the value of the property that is the subject matter of the ROFR at the time of the breach less the cost to acquire the property. If the third party offer was at market value then there will be little if any actual damage. In all cases, care should be taken to avoid missing a ROFR and its deadlines. The take away from this article is to always indicate the presence of a ROFR in your lease abstracts and particularly the details.