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Rights of first refusal - by Bryan Anderson and Thomas Kearns

July 16, 2019 - Front Section

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Rights of first refusal (ROFRs) in real estate transactions are common, as is the litigation surrounding them. One of the reasons for the frequency of litigation is that, if not thoughtfully and carefully drafted, ROFRs can be broader reaching than intended and can obstruct future deals.

The recent Clifton Land Company LLC v. Magic Car Wash LLC Third Department case illustrates some of these challenges. Clifton Land, a company that was in the car wash business, had negotiated a ROFR on property improved by a car wash giving it the right to purchase the property "on the same terms as set forth in the third party offer." The owners of the property sought to sell the property to a third party who owned a car wash across the street, and made the proposed transaction subject to a restriction on the use of the property preventing it from being used as a car wash for a period of ten years. Clifton Land sought to enforce its ROFR without being subject to this restriction. The court found that the ROFR was enforceable and not subject to the use restriction noting that the restriction was targeted to prevent the plaintiff from exercising its ROFR. The owners and third party buyer had not tried to ignore the ROFR but, rather, had tried to work around it by making it undesirable to the ROFR beneficiary. More carefully drafted limitations on this ROFR right may have provided the owners with greater freedom to transact.

We have seen similar challenges with ROFRs that were not well conceived at the time they were adopted. We represented a lender in a recent financing who negotiated a ROFR on a to-be-constructed building of the borrower in connection with the loan for the acquisition of the land. The borrower was happy to agree to the ROFR provisions at the time of closing the loan but was less happy when it came time to refinance the loan with a new lender and that new lender wanted the ROFR removed. As drafted, the ROFR was a stand-alone agreement operating independent of the loan. In the end, the borrower paid additional consideration to obtain a release of the ROFR from the lender in order to proceed with the refinancing transaction. Had the ROFR been limited in duration to the repayment of the financing or otherwise more carefully limited, the borrower may have had an easier time negotiating the refinancing.

Both of these scenarios illustrate that ROFRs create deal friction for new deals, but also illustrate the more subtle point that ROFRs are often not given their due attention and properly limited (whether temporally or substantively) at the time of original execution. Parties should think twice before readily agreeing to ROFR provisions, and take the time to carefully draft the provisions to avoid ambiguities and to avoid giving undue leverage to the ROFR beneficiary to obstruct future deals.

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