It Seemed Like a Good Idea at the Time: Rights of First Offer and First Refusal

First Rights Can Cause More Problems Than They Solve

By Joshua Stein

Nobody, except perhaps a plumber, gives much thought to the pop-up stopper in most bathroom sinks. These pop-up stoppers are everywhere. They've been around for ages. When did you last see a bathroom sink with a rubber stopper on the end of a chain?

The basic idea makes sense: build the stopper into the drainpipe so no one needs to fiddle with, or keep track of, a grotty-looking plug and a chain. And set it up so anyone can operate it with a quick flip of a lever or a pull on a knob.

But in my limited experience—I'm a lawyer, not a plumber—bathroom sink pop-up stoppers never work the way they should. Sometimes the seal on the stopper doesn't fit closely enough to the rim of the drain. Sometimes the mechanism goes out of whack and no amount of tugging on the control knob will seal the drain. Sometimes, something in the mechanism gets disconnected deep in the bowels of the bathroom sink. In any event, the result is usually the same: the drain won't seal and the water goes down the drain. Or sometimes the drain plug just closes and refuses to open.

Leaky or broken bathroom sink pop-up stoppers remind me of some provisions often found in ground leases. They sound like terrific ideas but rarely work right in the real world, and often instead create dissatisfaction and uncertainty, even litigation, for all involved.[1]

The provisions I have in mind are rights of first offer (each, a "ROFO") and rights of first refusal (each, a "ROFR," typically pronounced as "roafer" rather than spelled out). These rights (each, generically, a "First Right") arise if one party (an "Offeror") decides it wants to sell its interest in the property or the transaction (Offeror's "Interest").[2] In a ground lease, Offeror's Interest would consist of the ground lessor's leased fee estate or the ground lessee's leasehold. A First Right says Offeror cannot sell its Interest unless Offeror first gives the other party (the "Offeree" under any First Right) an opportunity to buy that Interest. The idea has a ring of fairness and logic to it. Whoever first came up with it was really creative. But, as this article will demonstrate, what seemed brilliant and creative in theory doesn't always work so well in practice—just like the drain stoppers in all those bathroom sinks.

This article concludes by offering some specific suggestions for how to write and live with First Rights, taking into account the rest of the discussion. Many of those suggestions are implemented in a Model Right of First Offer that accompanies this article. That Model ROFO includes some introductory comments on how the model ROFO language fits with the rest of the Lease. Footnotes in the model ROFO overlap many comments in this article.

Once a First Right exists, this article also offers a roadmap for compliance or for kicking up dust, if desired. And, as an overarching and even better suggestion, this article considered as a whole provides a roadmap to persuade one's client not to spend real dollars—potentially a significant number of them—to negotiate complex First Rights that will at best produce a dispute at some time in the future. That may be the most valuable service a lawyer can provide to his or her client once the parties start to talk about First Rights.

Business Context • Ground lessors often agree to grant First Rights to ground lessees, largely because the parties endured a ground lease negotiation—rather than an outright sale of the premises—because the ground lessor allegedly wanted to continue to own the fee estate forever and had no interest in selling. If the ground lessor ever changes its mind, it seems reasonable to give the ground lessee—who has a major investment in and a long-term commitment to the property—another shot at buying the ground lessor's Interest. A First Right also lets the ground lessee protect itself from an unknown and perhaps undesirable new ground lessor.[3]

A ground lessee will also sometimes give First Rights to its ground lessor. Then, if the ground lessee ever decides to sell, the ground lessor can prevent the ground lessee from selling to the purchaser it found or plans to eventually find (an "Offeror's Purchaser"), and instead pre-empt the sale by exercising its First Right. The inclusion of these clauses may reflect a desire for symmetry; a desire to protect the ground lessor from an undesirable or at least unknown new ground lessee;[4] or a simple exercise of negotiating leverage to create future opportunities for the ground lessor, either to execute a favorable transaction or at a minimum to torment the ground lessee.

Joint venture ("JV") agreements often establish First Rights between the venturers. Though this article focuses on ground leases, most of the discussion also applies to First Rights in JV agreements.[5] First Rights also appear in space leases, but they create a much narrower range of issues than those discussed here.[6]

Deficiencies • Regardless of the deal context, actually trying to exercise a First Right—or having one exercised against your client—will make it clear

that First Rights are like those pop-up drain stoppers that never work correctly. First Rights turn out to work badly, or not at all. But you can never predict exactly what problems and issues they will cause, or when or how. You can, however, safely predict that if anyone ever reads the First Right clause in the ground lease, the next act in the play will probably not be pleasant. One party or the other will feel it is being oppressed, or will try to exploit a leverage opportunity. And, of course, once in a while, a First Right may play out just fine with no disagreement at all.

Some Examples

I have recently lived through three major adventures, each with a different client, each of which involved a First Rights clause, negotiated before I became involved. In all three cases, the contractual language on the First Right failed to answer some basic questions. And though the contractual language did define some rights and obligations of the parties, some of rights and those obligations in some ways made little sense. The First Rights just did not work, at least from the perspective of the Offeree, who ended up thinking he got less than he bargained for because the First Right created very little value.

Almost every one of the problems discussed in this article arose, or were at least identified, in the three matters I mentioned above; a fourth First Rights matter that led the parties to negotiate another resolution; and a fifth, involving a decades-old ground lease, where a First Right process has not started yet but could soon. Each of the three completed matters involved a major building in Manhattan. In no case did the Offeree actually exercise its First Right. In no case was the Offeree happy with the process, the contract documents, or the outcome. But in no case did the matter go into litigation. And in each completed matter the Offeror did achieve its ultimate business goal: a safe and not too painful exit from, or resolution of, a relationship it regarded as unsatisfactory.

Why Bother with First Rights, Anyway?

If First Rights do not work very well, why bother with them? No Offeror would voluntarily give an Offeree a First Right. Offerees demand them as part of "making a deal," in the belief that they may create benefits and opportunities later. In some sense they often amount to a "throw-in"—not a fundamental economic motivator for the deal but an extra goodie that might help and can't hurt the Offeree—but something the Offeree demands, sometimes quite vociferously, as the price of doing the deal. From that vantage point, even if First Rights are never perfect, they are substantially better than nothing to an Offeree; Offerors can sometimes be persuaded to grant them; so why not grab them for whatever they are worth? One can also argue that First Rights, however imperfect they may be, are "market standard" or at least "common" in ground leases, especially as they relate to a possible transfer of the ground lessor's fee estate.

Definitions of Terms: ROFO vs. ROFR • The many problems with First Rights start at the very beginning, with the definitions of terms. What's a ROFO? What's a ROFR? Clients throw these acronyms around rather loosely, to refer to any concept of giving the other party a pre-emptive chance to purchase before an Offeror sells its Interest to an Offeror's Purchaser. In common parlance, the term ROFR often captures a ROFO as well.

What Happens and When

My informal research suggests that many commercial real estate professionals believe a ROFO (as opposed to a ROFR) arises right at the beginning of the selling process, i.e., when an Offeror first decides it wants to go into the marketplace to try to make a deal and eventually sell Offeror's Interest to an Offeror's Purchaser.[7] Before the Offeror even starts that process, the Offeror must offer (the "first offer") the Offeror's Interest to the Offeree, at a price the Offeror specifies in a notice to the Offeree (a "First Right Notice"). If the Offeree does not meet the price in the First Right Notice, then the Offeror can sell to an Offeror's Purchaser, as long as the Offeror achieves at least a high percentage (typically 95 percent) of the price the Offeror proposed in the First Right Notice.[8]

A ROFR, on the other hand, requires the Offeror to go into the market, find an Offeror's Purchaser, then give the Offeree a First Right Notice allowing the Offeree to match the purchase price proposed by the Offeror's Purchaser.[9] One might better call a ROFR a "right to match."[10] And clients often say ROFO when they mean ROFR, and vice versa.[11] Sometimes, they talk about a "right to match" when they mean a ROFR or even a ROFO.[12] And they rarely give much thought to how any of these First Rights might play out in the real world. They leave those details to the lawyers.

A ROFO lets the Offeror clear the decks before going out into the market to try to sell its Interest. If the Offeror gives a valid First Right Notice and the Offeree does not respond in time, the Offeror can go about its business—marketing, bidding and negotiating—without having to explain[13] to prospective Offeror's Purchasers that the Offeree might match their bids. With a ROFR, though, the Offeror will worry, with good reason, that prospective Offeror's Purchasers will not take the Offeror's offering seriously if the Offeree can pre-empt any attractive transaction the Offeror and the Offeror's Purchaser negotiate.[14] A ROFR will drive away Offeror's Purchasers, thus driving down the Offeror's selling price.

On the other hand, a ROFO forces an Offeror to figure out satisfactory pricing when it gives a First Right Notice, long before it has fully exposed Offeror's Interest to the marketplace. The Offeror may set its price too high or too low in the First Right Notice. If the Offeror sets too high a price, then it won't find any serious interest from potential Offeror's Purchasers without substantially lowering its asking price, which will require enduring the First

Right process once again. If the Offeror sets too low a price, then the Offeree might snap up the Offeror's Interest and the Offeror will leave money on the table, every Offeror's worst nightmare.

An Offeror can, of course, reduce those risks by doing some marketplace homework before naming its ROFO price. That often happens.[15] But the process will still probably lack the discipline, information flow, and reliability that full market exposure and real bids from real potential Offeror's Purchasers might have produced. The Offeror's willingness to live with that imperfection may depend in part on just how "generic" the real property in question actually is. It may be easier for the Offeror to estimate pricing for an ordinary rental apartment building than for a building that has a museum, five restaurants, an observatory, office space, and some high-tech workspace.

Think ROFO First

In my experience, if any party to a real estate transaction cannot avoid granting a First Right, it will typically prefer to grant a ROFO rather than a ROFR. On the other hand, plenty of smart people favor the ROFR. In my experience, the Offeror's desire to simplify third-party marketing usually outweighs the burden of the Offeror's having to come up with pricing for the ROFO before going to market.[16]

Giving the First Right Notice; Time to Respond • For any First Right, if an Offeror ever wants to sell,[17] the Offeror will have to give the Offeree a First Right Notice,[18] triggering the Offeree's First Right and allowing the Offeror to proceed only if the Offeree chooses not to exercise.[19] The Offeree must then respond to the First Right Notice so quickly that the First Right becomes at worst useless and at best highly problematic.

Is It Ever a Good Time?

After an Offeree receives a First Right Notice, the Offeree generally has only 30 days (the "Deadline") in which to exercise its First Right. But if an Offeree receives a First Right Notice, even the most diligent Offeree will need a few days to figure out what the First Right Notice is, what to do about it, which lawyer to call,[20] and what its rights and options are. First Right Notices have a habit of arriving on the Friday before a long weekend, or when the decision-maker is out of town, or during some extended period of religious holidays. For those and other reasons, the typical 30-day Deadline often effectively allows 20 days or less.

With the Deadline approaching so quickly, an Offeree has little time to decide whether it wants to buy the Offeror's Interest—typically a major capital investment that may or may not match the Offeree's current investment agenda, liquidity, time horizon, and funding position. The Offeror's timing won't necessarily match the Offeree's appetite or timing. Particularly if the Offeror is the ground lessee, the Offeree's decision requires significant underwriting and due diligence, somewhat mitigated by the Offeree's existing familiarity with the Offeror's Interest. In contrast, when the Offeror is the ground lessor, the Interest consists primarily of the right to receive a fixed or predictable series of payments for an extended time, so the analysis becomes easier. The Offeree must also figure out how to finance the purchase. A real estate investor will rarely have piles of cash sitting around waiting to fund the entire purchase price of the next deal.[21]

A conservative or cash-strapped Offeree will not want to commit to purchase unless it knows a lender is willing to provide financing for most of the purchase price.[22] But 20 days is barely enough time to engage a mortgage loan broker (if desired) and open conversations with potential lenders, let alone identify—and obtain a commitment from—a lender to support a purchase through a First Right.[23]

Even though the Offeree will not have to close within 30 days after receiving a First Right Notice, it will have only 30 days to decide and commit to close—with potentially serious consequences if it defaults. The Offeree cannot easily decide to exercise its First Right while ignoring the consequences of a possible change of heart.

The Deadline will become particularly burdensome if the Offeree, in addition to trying to decide whether and how to exercise its First Right, also tries to negotiate with the Offeror to resolve their relationship in some way other than the transaction that the First Right Notice contemplates. If the Offeree chooses to go down those two paths at once, each exercise will drain energy and focus from the other, and the 30 (really 20 or fewer) days will pass very quickly.

To mitigate these problems, an Offeree may want a contractual right to significantly extend the Deadline, in exchange for paying an extension fee, perhaps a high one, calculated on a daily basis. The Offeror will worry that any delay increases the risk of losing its Purchaser, or of deterring the Offeror's Purchaser from the outset. In my experience, however, most Purchasers aren't in a great hurry to close once they sign a contract, hence will probably not mind some additional delay, although that statement, of course, represents a gross overgeneralization.

An Offeree might also decide not to wait until it receives a First Right Notice. Instead, if the Offeree knows it might receive a First Right Notice at any time, the Offeree might plan ahead for it, or even proactively reach out to the Offeror to try to make a preemptive deal even when no First Right Notice appears to be on the horizon. And, as a variation on planning ahead for a First Right process, the Offeree might as part of the original deal try to negotiate limits on when and how the Offeror can send a First Right Notice. For example, perhaps the Offeror can only give a First Right Notice during the first calendar quarter, or must give an "advance warning" notice if the Offeror might decide to send a notice during a particular calendar year. An Offeror could still give a First Right Notice without complying with these conditions, but in that case the Offeree would have some extra time to respond or the Offeror might need to

include a payment to the Offeree to compensate the Offeree for the time, trouble, and disruption that the First Right Notice would trigger. Although the suggestions in this paragraph represent meaningful measures to protect an Offeree, I have never seen anyone actually use them.

Uncertainties About Valid Exercise • The next common problem with First Rights involves the garden-variety issue of making sure that if an Offeree does decide to exercise its First Right, it does so in a valid and effective way, sometimes not as easy as it sounds.[24] In the world of First Rights, the courts have been known to cut Offerees some slack if they do not exercise in strict compliance with the First Right, much as the courts sometimes excuse imperfections in the exercise of an option. An Offeror can try to protect itself from sympathetic courts by building appropriate protective language into the First Right.[25] And, to avoid any need to throw itself upon the mercy of the courts, sympathetic or otherwise, the Offeree should re-read the ground lease and the First Right Notice to ensure that it complies with the notice requirements as soon as it begins to consider exercising its First Right. And no law says exercise notices can only be sent on the day before the Deadline.

How to Do It

Even if an Offeree intends to exercise its First Right strictly in accordance with its terms, the exact requirements for valid exercise of a First Right may be uncertain, as I will describe below. The Offeror may have taken certain positions about what would constitute a valid exercise. If the requirements aren't clear, it may be hard for the Offeree to figure out exactly how to give a valid exercise notice. And if any substantive issues have already risen in informal discussions between the parties, those may themselves create concern about what constitutes a valid exercise notice.

In any such case, the Offeree may want to give two notices. The first would say as little as possible, merely referring to the ground lease and the First Right Notice and stating that the Offeree exercises its First Right. This first notice would comply with the literal requirements of the ground lease. It would otherwise take no position about what constitutes a valid notice or any other issues, thus avoiding giving the Offeror grounds to claim the exercise notice was invalid.

The Offeree could also give a second notice, addressing whatever issues have arisen and offering to resolve them quickly, but making clear that the first notice is unconditional and effective regardless of those issues or their resolution. The Offeree will probably not want uncertainty or issues to cloud the effectiveness of the exercise notice. The first notice would eliminate uncertainty about whether the Offeree actually exercised its First Right, while the second notice would formally open a dialogue about whatever issues required discussion.

Conversely, the Offeree may receive a First Right Notice that it claims is not valid, or may not respond at all before the Deadline. In that case, can the Offeror safely go ahead with an Offeror's Purchaser? Yes, but only if the Offeror is absolutely certain that the First Right Notice was valid and that the Offeree was completely wrong to claim that it was not.

Few Offerors and even fewer Offerors' Purchasers (and even fewer lenders to those Offerors' Purchasers) would want to proceed in the face of such a dispute. Whether or not a court would ultimately side with the Offeree, the mere existence of the dispute could seriously impede any further progress with an Offeror's Purchaser. If the Offeror ultimately prevails, does the Offeree face substantial liability for having derailed the transaction with the Offeror's Purchaser? Might the Offeree even face liability for merely failing to respond before the Deadline?[26] If a dispute arises about a First Right, what type of relief can the Offeror or the Offeree obtain? Damages? Only an injunction? Declaratory relief?

Ordinary language on First Rights rarely addresses these issues, just as it rarely addresses many others. For example, an Offeror may want the right to require the Offeree to issue a formal confirmation, in recordable form, acknowledging the Offeree has received a valid First Right Notice and chosen not to exercise it.[27] And if the Offeree thinks a First Right Notice is invalid, then perhaps the Offeree should have an obligation to notify the Offeror quickly, rather than wait until the day before the Deadline or say nothing at all.

Of course, if the First Right language requires the Offeree to provide formal notice or confirmation in response to a First Right Notice, then any Offeror's Purchaser will insist that the Offeror obtain it—thus guaranteeing that the Offeror will be at the mercy of the Offeree if the Offeree has any basis to try to refuse to issue the confirmation.[28]

Unless the First Right language protects the Offeree from liability if it incorrectly withholds a confirmation, the Offeree may hesitate to voice its objections to the First Right Notice for fear of incurring substantial liability to the Offeror. The Offeree would much prefer to see language expressly saying that any disagreement about these matters can be resolved only by issuance of an injunction or a declaratory judgment—perhaps by an arbitrator—much like language in a lease that exculpates a lessor from liability for unreasonably withholding a consent. Without that, the Offeree will fear that the Offeror will assert theories for huge claims against the Offeree if any dispute between them derails a favorable transaction with Offeror's Purchaser. Offeror will claim that Offeror's Purchaser was willing to pay far more than anyone else, and would have done so, but for the fact that Offeree wrongfully stood in the way by creating obstacles and claims that the Offeror regarded as spurious.

These hypothetical situations and risks may sound far-fetched and overly intricate, but issues like these can easily arise and become crucially important if any Offeror ever gives a First Right Notice. First Rights language rarely addresses the practical difficulties of a First Right Notice

process, which can be substantive and even expensive when a First Right dispute actually plays out.

When an Offeror negotiates a contract of sale with its Offeror's Purchaser (the "Offeror's Contract") and knows the Offeror's Contract may be subject to a First Right, it should consider the possibility that, when the Offeror gives a First Right Notice, the Offeree will raise issues with the Offeror. The terms of the Offeror's Contract should give the Offeror some breathing room—at least some extra time if needed before Offeror's Purchaser can walk—to deal with whatever claims a difficult Offeree might assert.

The parties may also want to consider the possibility that the Offeror will give a First Right Notice, but then later change its mind, deciding it wants to withdraw the Notice and halt the process. Can the Offeror do that? If the ground lease is silent on that point—and it usually is—then New York law would allow the Offeror to have its way, undo the First Right Notice, and restore the status quo.[29] That would probably hold true even if the Offeree had expended considerable time and resources considering whether to exercise its First Right and to arrange financing. If an Offeree regards that prospect as unsatisfactory, then it should negotiate language in the ground lease that prohibits withdrawal of any First Right Notice, requires a withdrawal fee, or at least after withdrawal prohibits the Offeror from sending another First Right Notice for a while.

Consequences of Valid Exercise • If an Offeree does decide before the Deadline to acquire the Offeror's Interest and successfully issues a valid exercise notice, what then? The typical First Right simply gives the Offeree an option, a possible purchase price based on the First Right Notice, and perhaps a deadline for closing. Sometimes the First Right language contemplates that the parties will negotiate some form of industry-standard purchase and sale agreement. That can invite delay or disaster. Those negotiations will probably fail if the Offeror is not enthusiastic about the transaction, which one should assume will always be the case. And sometimes the timeline for those negotiations contemplates that the parties will agree on a form of contract by the Deadline—a virtual impossibility.[30]

An industry-standard purchase and sale agreement would ordinarily require the purchaser, here the Offeree, to fund a deposit at the time of signing the contract. The Offeree would probably disclaim any obligation to fund any deposit at all, particularly if the First Right language says nothing about contractual terms, beyond a bare obligation to purchase and sell the Offeror's Interest. After all, inferring an obligation to fund a deposit if no written document identifies its amount is a difficult task.

Whether or not the Offeree funds a deposit, what happens if the Offeree exercises the First Right, and then defaults? Does that constitute a default under the ground lease? If the ground lessee is the purchaser, the prospect of a lease default arising from a failure to close after exercising a First Right could create serious angst for leasehold mortgagees. Ground lessees and their lenders will therefore want to make it very clear that any purchase transaction triggered by a First Right has nothing to do with the ground lease itself. From the Offeree's perspective, the two should not be cross-defaulted.[31]

And what about all those other terms that often make negotiation of an ordinary purchase and sale—really a very simple transaction—so complex and protracted?

What representations and warranties should the Offeror make? Should they be subject to baskets? Floors? Caps? Those questions may be less troublesome than usual in a contract arising from a First Right, given the Offeree's overall familiarity with the Offeror's Interest, but the Offeree will still worry about what the Offeror might do to frustrate the Offeree's expectations under the contract. One might resolve at least a good number of these issues by saying that until the closing, the parties must continue to perform all their obligations under the ground lease, and won't do anything that would violate the ground lease or affirmatively diminish the value of the Interest to be sold.

Another problem, more specific to a First Right: if an Offeror sold to an Offeror's Purchaser the Offeror would probably need to pay a brokerage commission out of the selling price. If the Offeror sells to the Offeree, the Offeror might avoid that expense. Who should benefit from those savings? How should they be quantified?

That's not the end of the contractual issues that First Rights language will often fail to address. When must the Offeree close? Can the Offeree adjourn the closing? What about condemnation? Adjustments? Real estate tax protests? Pending litigation? Uncertainty about ground rent calculations or payments? Payment of transfer taxes? Prepayment or yield maintenance fees? Environmental risks? Unpaid brokerage commissions? Credit against the purchase price for future free rent periods? Permitted title exceptions?[32] Obligations to clear unexpected title issues?

The First Right language will often fail to address these and many other contractual provisions. Ninety-nine percent of a purchase and sale transaction consists of the purchase and sale itself, so that might not be tragic. But the other one percent of the transaction often incurs legal fees that outweigh the practical value of these issues to the parties. All too often, the ground lease does not consider how most of those issues would be handled if the Offeree decides to exercise its First Right.

For a First Right to work well, the parties should give some thought to the multitude of issues that arise even in a simple purchase and sale contract, and either define in the First Right how those issues will be handled or establish a simple, quick way to fill the gaps. The First Right language might also require the Offeror to specify all "material terms" of any proposed sale in the First Right Notice, and perhaps

define what the "material terms" would be. If the First Right language leaves these issues open, the Offeror and the Offeree will need to negotiate them when the Offeree exercises its First Right. There is no reason to think those negotiations will succeed, and every reason to think they will fail.

Offeror's Contract as A Guidepost?

• In the case of a ROFR—as opposed to a ROFO—a mechanism does exist to determine all the terms under which the Offeree would need to buy if it exercised its ROFR: matching the Offeror's Contract. Though that approach seems simple and logical, as always in the world of ROFOs and ROFRs, appearances of simplicity and logic can be deceiving.

The Offeror's Contract could contain terms that the Offeree has no ability to match, like an obligation for the Offeror's Purchaser to deliver certain real property in exchange for the Offeror's Interest. To respond to that concern, First Rights language will often say that the Offeror's Contract must require payment of the purchase price in cash at closing—with no purchase-money financing and no other consideration beyond the purchase price for the sale.

Reasonable enough, but Offeror will often have bona fide reasons for an Offeror's Contract to require consideration beyond the stated purchase price: for example, a possible future payment to reflect the outcome of a pending issue such as a construction dispute, or an earn-out. Does that future payment—even though reasonable, bona fide, and agreed to in good faith—invalidate the First Right Notice? If not, the Offeree will need to have the ability to understand and quantify the likely payment before deciding whether to exercise its ROFR. The First Right language should give the Offeree the ability to obtain all the necessary information as well as time to process it. If the Offeror provides missing information the day before the Deadline, the Offeree should have the right to an extension.

Does the Offeror's Contract give Offeror's Purchaser a due diligence period with the right to terminate if Offeror's Purchaser doesn't like what it finds? We all know that a due diligence period often allows the purchaser to renegotiate the purchase price based on alleged deficiencies or allegedly unexpected facts discovered in the due diligence period, or because the deal doesn't "appraise out" (i.e., the buyer can't find the money, i.e., can't justify the price it's paying). If the Offeror's Contract has an unexpired due diligence period, should it trigger a ROFR at all, or only after the due diligence period has lapsed?

Any Offeree will also worry about the closing date in the Offeror's Contract. The Offeror's Purchaser probably will not sign the Offeror's Contract until after it has completed its due diligence, and found a lender that can be trusted to close. The closing might happen relatively soon after all parties sign their Offeror's Contract.

If the Offeror blindsides the Offeree by giving a First Right Notice, though, the Offeree will have had no preparation time at all. The Offeree may well need more time to close than would an Offeror's Purchaser.

ROFRs do often give the Offeree some minimum guaranteed time in which to close, even if the Offeror's Purchaser would have closed faster. Practically speaking, though, the closing timeline may often still be too tight for an Offeree that starts from square one. Thus, the Offeree will probably want the First Right language to give the Offeree at least (for example) 60 or 90 days to close. Perhaps the Offeree should have the right to a reasonable extension, with or without a payment for that extension.

Other provisions in the Offeror's Contract might cause an Offeree concern, such as extreme or unusual remedies for default; an extraordinarily high deposit; requirements for credit support that the Offeree simply cannot satisfy; restrictions on assignment; or provisions that otherwise do not match the Offeree's likely business agenda. The Offeror's Contract shouldn't have weird closing conditions. The Offeror should make reasonable representations and warranties. The possibility of assuming an existing mortgage creates its own set of issues, especially if the existing mortgage is held by a securitization trust. The Offeror's Contract can't have other terms that would create an unusual and impractical burden for the Offeree, frustrating its ability to exercise its ROFR. Smart lawyers can think of a long list of criteria for the Offeror's Contract.[33]

Concerns like these may lead either party to insist on defining the form of the Offeror's Contract as part of the original transaction, attaching it as an exhibit to the ground lease. That does not seem to be market standard. No one seems to want to go to the trouble. And it may not be possible to foresee everything the Offeror's Contract might ultimately need to address.

Once the parties define the form of the Offeror's Contract, the Offeree will want to restrict amendments. Going a step further, a careful Offeree should worry not only about the terms of the Offeror's Contract but also about what it doesn't say. For example, a devious Offeror could "get around" the Offeree's ROFR by calling for an above-market price in the Offeror's Contract but simultaneously entering into some other agreement with Offeror's Purchaser. It could be as simple as an agreement for the Offeror to provide below-market services after the closing or as sophisticated as a simultaneous sale of another property at a below-market price, but conditioned on the closing of the above-market transaction under the Offeror's Contract.

Very likely each of those deal structures constitutes fraud. Maybe we should assume everyone is ethical and no one will commit fraud, so we should not worry about it. But we devote a lot of time and thought in real estate transactions to identifying and squeezing out the possibility of fraud. We are not willing to assume parties will behave in an ethical and upstanding way. Think about the recording system, for example. Its primary purpose is to prevent fraud, i.e., a sale of

the same property to two purchasers. Escrows serve a similar function and appear all the time in real estate transactions.

In assessing the likelihood of the occurrence of any scheme of the type suggested above, the Offeree might or might not take comfort from its knowledge of the Offeror's character and business ethics. If not, the Offeree could at a minimum insist on receiving some certification from the Offeror's Purchaser's about the absence of other agreements. Similarly, the Offeree might also worry about future amendments of the Offeror's Contract, particularly ones that could make the economics more favorable to the Offeror's Purchaser. Should any such amendment require the Offeree's consent? Should it entitle the Offeree to a new First Right Notice?

Rather than parse through and consider every possible provision that might appear in the Offeror's Contract, an Offeree might insist that the ground lease define a simple contract that would govern if the Offeree exercised its First Right—regardless of the terms of the Offeror's Contract.

Flipping the Transaction • If an Offeree receives a First Right Notice and the idea of the Offeree's buying out the Offeror's Interest at the proposed price has no appeal at the moment, should the Offeree do nothing and let the Offeror proceed with an Offeror's Purchaser? Not necessarily. The Offeree may think the Offeror is selling too cheap; it could purchase the Offeror's Interest and resell it to someone else for a profit. The Offeree might even decide to throw in the Offeree's own Interest, offering both fee and leasehold on a combined basis and making a larger profit as a result.[34]

Even if the Offeror's offering price in the First Right Notice seems reasonable, the Offeree may prefer to bring in a known third party to acquire the Offeror's Interest (an "Offeree's Purchaser"), as opposed to an unknown and possibly undesirable Offeror's Purchaser. For these and other reasons, the Offeree may want to figure out a way to exercise a First Right, for the benefit of an Offeree's Purchaser, even if the Offeree itself does not want to acquire the Offeror's Interest.

Can It Really Be Done?

The time constraints of a typical First Right make it almost impossible, though, for an Offeree to do any of this. If, as noted earlier, the typical 30-day Deadline does not give an Offeree—except one that is extremely wealthy and cash-rich—enough time to find a lender, it surely does not give an Offeree enough time to find an Offeree's Purchaser and for that Offeree's Purchaser to then find its own lender. Thus the Offeree will not be able to squeeze out of the First Right an opportunity to bring in an Offeree's Purchaser or make a profit or both. If those opportunities represented one reason the Offeree wanted a First Right, then it probably will not achieve its goal.

Will the Flip Work?

Let's suppose, though, that a prescient Offeree negotiated a First Right with a Deadline generous enough that: (a) the Offeree could find an Offeree's Purchaser to buy either the Offeror's Interest or conceivably both the Offeror's and the Offeree's Interests; and (b) the Offeree's Purchaser could find a lender and close a loan. Even then, the "flip" transaction might not work, because the typical First Rights language creates stumbling blocks for the Offeree.

First, if the Offeree chooses to exercise the First Right, the ground lease will often just say the Offeree must acquire Offeror's Interest. That is just what the words say. No one thought of the possibility that the Offeree might want the right to designate someone else to acquire Offeror's Interest, or to assign the Offeree's First Rights or any resulting contract to an Offeree's Purchaser. So the actual closing might in fact require two closings, with two potential sets of transaction costs. At best, the Offeree might need to agree to acquire the Offeror's Interest, and then only have the right to designate the actual purchaser at closing. There would be a huge number of issues to consider, and knotty negotiations with the Offeree's Purchaser. After the burdens described in this paragraph, the flip transaction might not make sense.

Second, the Offeree would need to negotiate a contract with the Offeree's Purchaser, covering its sale of the Offeror's Interest to the Offeree's Purchaser, after the Offeree acquired it (or obtained the right to acquire it) by exercising its First Right. A different problem then arises: merely negotiating a "flip" contract might require the Offeree to give (or to have given) the Offeror a First Right Notice, entitling the Offeror to acquire whatever the Offeree was getting ready to agree to sell to the Offeree's Purchaser. A simple flip of the Offeror's Interest will send the Offeree down a separate road in giving the Offeror a new First Right, with its own First Right Notice, Deadline, and issues. That prospect will almost certainly cause delay, confusion, and headaches, and may even derail the Offeree's flip completely.

Third, if the Offeree wants to go a step further and offer the Offeree's Purchaser the Offeror's Interest as well as its own, then this increases the likelihood that the Offeree will need to give the Offeror a First Right Notice based on the Offeree's sale of its own Interest. Again, this creates practical problems and delays, potentially preventing the Offeree from completing the flip transaction with the Offeree's Purchaser.

If the Offeree anticipates entering into any flavor of flip transaction by exercising a First Right, then it will need to make sure the First Right language allows it. Once the Offeror has given a First Right Notice, First Right language should ideally allow the Offeree to structure whatever transaction it wants, including any assignments, as long as the Offeree matches the price in the First Right Notice. At that point, the Offeror already wants to exit the transaction, so why should it have the right to torment the Offeree by claiming the right to claw its way back in if the Offeree decides to sell its own Interest?[35]

Conversations with Offeror's Purchaser • In considering the Offeror's Contract and deciding how to respond to the First Right Notice, the Offeree may find itself tempted to open a dialogue with the Offeror's Purchaser. For example, the Offeree might offer to waive its ROFR if the Offeror's Purchaser agrees to an adjustment in the ground rent. Or the Offeree might see an opportunity to structure a profitable transaction that would involve the Offeror's Purchaser in some way. After all, the Offeror's Purchaser is unique in that the Offeree already knows with certainty that Offeror's Purchaser has a genuine interest in acquiring Offeror's Interest, has already done its due diligence (one hopes), and might be willing to pay something more than the price in the Offeror's Contract.

If an Offeree yields to the temptation to speak to the Offeror's Purchaser, then any such conversations may, at a minimum, violate real estate etiquette. But do they expose the Offeree to potential liability? What if they somehow lead the Offeror's Purchaser to take actions the Offeror does not like?

The answer, as always, depends on all the facts and circumstances. My own limited research suggests, however, that ordinary business negotiations will not expose the Offeree to liability—though they could create potentially costly claims, which could require significant time and money to defend. An Offeree should probably resist the temptation to speak to any Offeror's Purchaser. Of course, if an Offeree has all the time and knowledge in the world when negotiating a First Right, the Offeree will insist that the First Right language includes the Offeror's consent to any such conversations.

As an alternative, the parties might move in the opposite direction and state that neither party can disclose anything about any First Right Notice or its consequences, and everything about the process is confidential.

Exclusions and Exceptions • As if the problems I have already discussed were not enough, First Rights can create other issues if an Offeror starts to think about transactions that should not trigger a First Right[36] and circumstances under which the First Right should go away.

For example, suppose an Offeror's overall business strategy involves the creation of a portfolio of similar assets, which the Offeror intends eventually to sell as a group or convert into a real estate investment trust. The Offeror will want to ensure that any such transaction does not trigger a First Right. The parties may address that concern by agreeing that if the Offeror's contemplated sale includes other property, then the Offeree's First Right does not apply and perhaps even goes away permanently.

How much other property must the transaction include to defeat the First Right?[37] In one recent transaction with a carve-out of this type, the Offeror informed the Offeree that it might decide to throw in a small property in another state, so the transaction would technically include "other property" and hence not trigger a First Right.

To that end, the Offeror, here the ground lessee, could also have argued: (a) that the First Right language exempted any transaction that involved any "other property" in addition to the leasehold; and (b) that under the facts of the particular contemplated sale, the Offeror would also have included a significant amount of personal property in addition to the leasehold itself. Would that have been enough "other property" to defeat the ground lessor's First Right? The question became a point of contention in the generally contentious discussions between the Offeror and the Offeree.

If a possible Offeror is a non-real estate company that could merge into some other entity, the Offeror will want to ensure that a sale of the Offeror's Interest in connection with that merger will not require the Offeror to issue a First Right Notice. That was exactly the issue that arose in 2008, when the Bear Stearns Companies, Inc. ("Bear Stearns") agreed to merge into JPMorgan Chase & Co. ("JPMC") at the height of the financial crisis. As part of the merger agreement, Bear Stearns gave JPMC an option to acquire the leasehold of the Bear Stearns headquarters at a fixed price if the merger failed.

The Bear Stearns ground lessor asserted that JPMC's contingent option violated a ROFO in favor of the ground lessor, which required Bear Stearns to offer the leasehold to the ground lessor before offering it to anyone else. But the ground lessor's ROFO did not apply if "Tenant shall determine to sell, transfer or otherwise dispose of its interest in this Ground Lease to...any entity into which or with which Tenant may be merged, consolidated or combined or any entity which shall purchase all or substantially of the assets of Tenant."[38]

The court concluded that the quoted exclusion from the ROFO was broad enough to protect Bear Stearns and JPMC from the ground lessor's claims, regardless of whether the merger actually closed. By referring to an entity into which Bear Stearns "may" be merged, the exclusion could defeat the ground lessor's claims even if the merger did not proceed; the fact that it "may" have occurred was enough to activate the ROFO exclusion.

The court's decision reflected a simple reading of the language of the ROFO exclusion in the Bear Stearns ground lease, with a generous interpretation of the word "may." When the negotiators of the ground lease threw in the word "may," did they really mean to cover the case where a merger seemed possible but ultimately might not have occurred? Who knows? It did not matter. The word "may" was broad enough to prevent a problem for Bear Stearns and Chase. And, of course, the merger did ultimately occur, sidestepping the issue.

To prevent a similar problem, the drafters of First Right language usually do remember to add an exclusion stating that a foreclosure sale affecting the Offeror's Interest does not trigger a First Right. They recognize that no lender would want to endure a First

Right Notice and the ensuing trail of trouble as the price of foreclosing on its collateral.[39]

If the Offeror envisions certain other possible transactions in its future, the Offeror may want to carve those out from the First Right as well. Examples might include a future joint venture with a developer, a transfer to a department store for development, transfers among affiliates, conversion to a different entity type or a tenancy in common, mergers or consolidations, or a transfer in contemplation of condemnation. An Offeror might also want a First Right to vanish after a certain number of years. The possibilities are endless. The Offeror should start by thinking about its long-term plans for its Interest.

Why Offeree Must Stay Alert

As a practical matter, if the Offeror's loan goes into default, any Offeree can achieve the functional equivalent of a First Right by bidding at the lender's foreclosure sale, though it does come with the burden of having to face competitive bidding and the uncertainties of any foreclosure sale. Is it then reasonable to ask the Offeror's lender to notify the Offeree of any upcoming foreclosure sale? That sounds like a great idea, but lenders typically refuse to undertake any such obligation. So, if the Offeror wants its Interest to remain financeable, the Offeree cannot expect the Offeror's lender to assume any legal obligation to keep the Offeree informed. The Offeree will need to keep its ear to the ground to find out about any upcoming foreclosure sale.[40]

First Rights And Future Transactions • First rights also need to deal with other possible contingencies. For example, if the Offeror gives a valid First Right Notice, the Offeree does not exercise its First Right, and the Offeror sells to an Offeror's Purchaser, should the First Right still apply when the Offeror's Purchaser later decides to sell again? If the ground lease says nothing, then the First Right could very well continue to apply, burdening every future Offeror and every future sale. A careful Offeror will argue that under these circumstances the Offeree had its opportunity to acquire the Offeror's Interest and should not have another. The Offeror would insist that under these circumstances the First Right should no longer apply to future transactions. The Offeror, and particularly the Offeror's Purchaser, may want the Offeree to agree to confirm in writing that the First Right has fallen away and will never come back.[41]

Conversely, the Offeree may actually want the First Right to survive a sale to an Offeror's Purchaser and continue to apply to all future possible sales. In that case, the ground lease should say so.

The Offeree might also exercise the First Right and then fail to close. If that happens, the Offeror might reasonably say that the Offeree had its opportunity to buy the Offeror's Interest. Having defaulted, the Offeree does not deserve another shot, so the First Right should terminate.

An Offeree might have similar thoughts. For example, an Offeree might point out that if the Offeree takes a First Right Notice seriously, then figuring out how to respond will require an enormous amount of time, energy, and legal fees. Thus, if an Offeror gives a First Right Notice, then perhaps it should not be allowed to give another until a certain amount of time has passed. As an alternative, if the Offeror does give another First Right Notice within a certain period, the Deadline might be much more generous than otherwise.[42] And if the Offeree sells its position, perhaps the First Right should fall away in any event.

Conversely, if the Offeree passes on its First Right and the Offeror fails to close a transaction, then the Offeror may want to be excused from giving any more First Right Notices for a certain time, unless the offered price drops by more than 5 percent.

All these permutations, variations, and implications may seem overwhelming, but when a First Right actually arises in the real world, they can make a huge difference. Rarely, though, will the drafters of a First Right think of most of them.

As a variation on the concept of excluding certain transactions from the First Right, any drafter of a First Right might want to consider requiring the Offeree to make some modest annual payment to preserve its First Right. Any such measure would incentivize the Offeree to abandon its First Right if the Offeree ever doesn't really attach meaningful value to the First Right. I have never seen any such provision in a ground lease, however.

Conclusion • First Rights can create a variety of legal and practical issues, both in negotiations and in real life if anyone ever actually exercises a First Right. No one should place great weight on First Rights as a source of reliable protection or value in a deal. From the perspective of an Offeree, though, having any First Right—even a bad one—may seem better than having no First Right at all. Regardless of how poorly drafted or impractical it is, a First Right will at a minimum give the Offeree leverage and some (maybe not much) opportunity to cause issues and delays. It may force the Offeror to pay attention to the Offeree, and, if nothing else, pick up the telephone and have a conversation, or pick up a checkbook and make a payment.

In general, though, like those faulty pop-up drain stoppers, First Rights almost always work better in theory than in practice.

But First Rights may actually be worse than leaky drain stoppers. Besides failing to function properly, First Rights also create a world of trouble and surprise for all parties involved, adding layers of complexity to transactions that could have been relatively simple. Practically speaking, First Rights may just force the parties into negotiating an amicable parting of the ways to avoid the headaches this article describes.

Drafting Suggestions • If an Offeror cannot avoid granting a First Right, what can the Offeror do to avoid disputes? And when an Offeree negotiates a First Right, how can the Offeree

maximize the practical value of that First Right? Here are some suggestions, inspired by the preceding discussion. These suggestions could apply to either the Offeree or the Offeror, or sometimes both of them. The reader will need to make that determination, as well as a determination of whether the reader's client will benefit or suffer as a result of the many problems that First Rights can create.

- *Just Keep Saying No.* An Offeror should do what it can to head off a First Right even before the parties start to negotiate the ground lease. For example, say in the term sheet something like this: "The Lease shall establish no conditions or restrictions to either party's sale of its interest in the Property."
- *ROFO vs. ROFR.* I believe an Offeror should usually prefer to grant a ROFO rather than a ROFR in most cases. As noted above, others disagree.
- *No Cross-Default.* Any ground lessee will want to make sure that any default under a First Right does not trigger a default under the ground lease.
- *Second Bite.* If the Offeror gives a First Right Notice and the Offeree doesn't bite, but the Offeror later improves the deal it offers to a third party, the Offeree should have a reasonable "second bite." But try to define "improvement."
- *Future Documents and Obligations.* The First Right language should leave nothing to be negotiated, resolved, or signed later (beyond a notice of exercise) to implement the First Right. The ground lease should define the rights and obligations of the parties, recognizing that if a First Right ever becomes relevant the parties will almost by definition find themselves unable to negotiate anything.
- *Timing.* An Offeree will probably need more than 30 days to decide whether to exercise its First Right. Give the Offeree a somewhat painful right to extend its decision period by up to, say, 30 days. If the Offeree exercises, allow a reasonable time to obtain financing and close, perhaps with another painful right to extend.
- *Triggering Events.* Specify exactly what will trigger a First Right. An Offeror's mere intent to sell or expose its Interest to the market should not activate the First Right. Something more needs to happen to trigger the First Right.
- *Exercise.* Define with total simplicity exactly what the Offeree needs to do to exercise its First Right. Perhaps attach a form of exercise notice as an exhibit to the ground lease.
- *Contract Terms.* If Offeree exercises its First Right, make the resulting contract between Offeror and Offeree as simple and unambiguous as possible. Try to define all the contract terms in the ground lease, leaving nothing for discussion. In particular, think about exactly how the parties will calculate the final net purchase price. If the Offeror will avoid some ordinary transaction costs, who should get the benefit of those savings? How does one measure them? The contract issues in any purchase and sale are really not all that complicated.
- *Failure to Exercise.* If the Offeree decides not to exercise its First Right, it should agree to confirm that waiver in writing, to avoid concern by the Offeror's Purchaser. Failure to exercise should have consequences, at least for some period.
- *Flip?* Either expressly prohibit the Offeree from entering into a flip transaction, or facilitate any such transaction by saying that it does not trigger a new First Right, and the Offeror must cooperate in certain customary ways to allow a flip. But decide one way or the other.
- *Mortgagee Protection.* Beyond saying that a mortgage foreclosure does not trigger a First Right, the First Right language should also permanently go away if a mortgagee ever completes a foreclosure.
- *Exclusions May Apply.* Other than protecting mortgagees and transactions among affiliates, what other exclusions should an Offeror try to add to any First Right?
- *Loan Coordination.* In negotiating permitted transfers in a mortgage loan, try to build in exceptions for transfers that occur through exercise of a First Right.
- *Communications.* Rather than rely on any First Right, any Offeree should try to maintain good relations and lines of communications with the Offeror, so the parties can have a conversation instead of enduring any First Right process and all the issues it can entail.
- *Notice Address.* If the Offeree moves, it should notify the Offeror of the Offeree's new address for notices.
- *Giving a Notice.* In giving a First Right Notice, the Offeror should scrutinize the First Right language in the Lease and make sure the notice fully complies. What creative arguments might the Offeree make to support a claim of invalidity? Negate those arguments in advance.
- *Disputes.* If the Offeror and the Offeree disagree about the operation, implementation, or meaning of a First Right, or any notice given pursuant to a First Right, provide for an expedited arbitration or other dispute resolution process and a limitation of remedy and liability.

Endnotes

1. The number of reported cases involving First Rights is astonishing, demonstrating that First Rights fail at an extraordinary rate. The volume of litigation suggests that no one should rely on First Rights as a reliable source of value beyond nuisance value and legal fees if you're a lawyer. The challenge in writing this article has been to separate the vast number of "ordinary" First Right lawsuits from the truly interesting ones, of which there are also many.
2. If an Offeror never decides to sell, then the First Right never arises. In contrast, a purchase option lets an Offeree buy on specified terms at certain time(s), whether or not Offeror wants to sell. Ground leases have fewer purchase options than First Rights, because a ground lessor assumes—often correctly—that the ground lessee will exercise any option at the first opportunity, defeating the ground lessor's goal of preserving long-term ownership and an annuity. An individual ground lessor's death sometimes triggers a purchase option, because the resulting basis step-up can finally make a sale palatable as a tax matter. The timing will also often correlate with the absence of an obvious successor to take over competent management of the ground lessor's position, assuming competent management matters.
3. Of course, the ground lessee should negotiate the ground lease so the ground lessee does not care who the ground lessor is. Because ground leases rarely restrict conveyances of the fee estate in any meaningful way, except sometimes through First Rights, the ground lessee should assume that the worst possible counterparty in the world will acquire the fee estate. The ground lease just needs to "work" for the ground lessee and its present and future lenders, regardless of the identity of the ground lessor. That's true even if the lease includes a First Right, as the Offeree will almost never actually exercise the First Right, hence will usually bear the risk that the Offeror will transfer to an unsavory buyer.
4. Just as the ground lessee should not care who the ground lessor is, the ground lessor should not care who the ground lessee is.
5. If anything, First Rights in JV agreements often raise more and larger issues. In the context of a JV, the stakes rise because if Offeree does not exercise its First Right, Offeror can often force a sale of the entire property, not just Offeror's Interest, and Offeree must cooperate. For example, a JV agreement will often say that if an Offeree does not exercise its First Right, then Offeror can require a sale of the entire property at a price equal to 95 percent or more of the valuation Offeror proposed for the entire property in its First Right Notice. If Offeror forces a sale of the entire property at that 95 percent "floor" price, can Offeror require a sale to one of its own affiliates? Can Offeree stop such a sale? Other footnotes in this article mention some but not all issues specific to First Rights in JV agreements. Buy-sell ("shotgun") clauses in a JV raise many issues similar to those in this article (text and footnotes), plus many more. If a dispute ever arises within a JV about a First Right, one of the first issues will relate to choice of counsel. Can the JV's counsel represent either of the venturers? Who negotiated the JV agreement for whom? Do the parties all need to go out and hire new counsel? (Probably.).
6. Those issues relate primarily to pricing and timing, and secondarily (from the lessor's perspective) to coming up with as many exceptions and exclusions as possible for any First Right. The lessor also must ensure that no two lessees can ever claim a First Right to the same space for the same period.
7. As an alternative, if and when Offeror has told Offeree that Offeror wants to sell, a ROFO could entitle Offeree to give Offeror the "first offer" for Offeror's Interest. That "first offer" would then define the floor for Offeror's sale to an Offeror's Purchaser. In my experience, though, the "first offer" in any ROFO comes from Offeror, not Offeree.
8. If Offeror wants to sell for less than the stated percentage of the price named in the First Right Notice, then Offeror must give Offeree another First Right Notice at the lower price. Offeree then has "another bite"—typically with a shorter response time because Offeree presumably now has done enough homework to respond faster and because Offeror will already be sick of the process and have a headache by this point. Offeree will also often get a second bite if Offeror plans to offer Offeror's Purchaser other terms "materially more favorable," whatever that means, than those in the First Right Notice. That concept opens up a whole new area for discussion and dispute. No two buyers have the exact same agenda. Even a simple purchase and sale agreement can be negotiated and retraded in many ways—both at the outset and as the parties proceed down the road toward a closing. At what point does that process give Offeree a "second bite"? As an aside, my informal and very limited research suggests that the concept of a "second bite" is more common in New York than elsewhere in the country.
9. A ROFR typically requires a fully negotiated and signed contract with Offeror's Purchaser, with the closing conditioned on Offeree not exercising its ROFR. This way, Offeree will know the identity of Offeror's Purchaser, unless the ROFR allows Offeror to submit a redacted Offeror's Contract. Offeree may regard the identity of Offeror's Purchaser as very important information. The need for Offeror and Offeror's Purchaser to fully negotiate an entire Offeror's Contract increases the burden of a ROFR on any Offeror and its efforts to negotiate a deal with an Offeror's Purchaser.
10. I have also heard references to a "right of last refusal" or "last right of first refusal," which I thought just meant ROFR, until I found the case described in this footnote. At least one court has distinguished a ROFR from a "last right of refusal" that gave Offeree an opportunity to beat—but not match—the terms of any bona fide offer. *Jeremy's Ale House Also, Inc. v. Joselyn Luchnick Irrevocable Trust*, 22 A.D.3d 6, 10, 798 N.Y.S.2d 416, 419 (1st Dep't 2005). In finding the distinction to be more than academic, the court stated that the right at issue was "not a [ROFR], with its well-known and recognized meaning as a preemptive right, but...a last right of refusal, thus according the right a different meaning." *Id.* at 8; 798 N.Y.S.2d at 419. While a ROFR would have given its Offeree a chance to match a third-party offer, the last right of refusal at issue in this case gave its Offeree "an opportunity it would otherwise not have [under a ROFR] and that no other bidder enjoy[s]." *Id.* at 8; 798 N.Y.S.2d at 419. The court said Offeree had the opportunity to "beat any offer...and the [third party] transaction could not close without affording [Offeree] that opportunity." *Id.* at 10; 798 N.Y.S.2d at 419.
11. Another variation on this theme, a "right of first negotiation," requires a prospective Offeror only to notify Offeree of Offeror's intention to try to sell its Interest. After that, the parties are supposed to try to negotiate a deal, often "in good faith" and on an exclusive basis. If they do not actually make a deal within some stated time, though, Offeror can go to market. These clauses have their own advantages and disadvantages, starting with the great advantage of simplicity, sidestepping most of the problems in this article. Logically, if the Offeree makes the best offer for Offeror's Interest, the Offeror should want to sell it to the Offeree. A potential recipient of a "right of first negotiation," though, would generally regard a traditional ROFO or ROFR as more solid and reliable. That proposition may sound convincing in theory, but the questions raised in this article may call it into doubt.
12. The New York Court of Appeals stated that a "right of first refusal" requires a property owner, "when and if he decides to sell, to offer the property first to the party holding the preemptive right so that he may meet a third-party offer or buy the property at some other price set by a previously stipulated method." *Metro. Transp. Auth. v. Bruken Realty Corp.*, 67 N.Y.2d 156, 163, 492 N.E.2d 379, 382, 501 N.Y.S.2d 306, 309 (1986). That definition of "right of first refusal" captures both a ROFO and a ROFR as this article defines them. The *Bruken* case considered whether the rule against

perpetuities applies to First Rights. The Court of Appeals stated: "the rule against remote vesting [perpetuities] does not apply to preemptive rights [*i.e.*, First Rights] in commercial and governmental transactions, [and] their validity is to be judged by applying the rule against unreasonable restraints." *Id.* at 168; 492 N.E.2d at 385; N.Y.S.2d at 312. Although this case and other more recent New York cases favor enforceability of "reasonable" First Rights, whatever that means, counsel should consider the Rule Against Perpetuities in structuring any First Right, particularly outside New York or involving individuals. *See, e.g., Morrison v. Piper*, 77 N.Y.2d 165, 566 N.E.2d 643, 565 N.Y.S.2d 444 (1990) (Rule Against Perpetuities applies to ROFR that involves an individual). The Rule Against Perpetuities has perpetual life. For a discussion of the rule against perpetuities as it applies to First Rights, *see* John C. Murray, *Option and Related Rights and the Rule Against Perpetuities*, N.Y. REAL PROP. L.J. 47 (2014).

13. Prospective Offeror's Purchasers will figure out the existence of a ROFR soon enough when they start their due diligence, *i.e.*, when they read the ground lease. Offeror may as well simplify the process and hopefully prevent surprises and emergencies by mentioning the ROFR early on. As its best strategy, Offeror might try to negotiate Offeree's waiver of the ROFR long before going to market. Offeree may or may not like that idea. Offeree may see it as just another revenue opportunity of the type that usually arises from time to time under any long-term Lease. An early conversation may give Offeree that opportunity without overcomplicating Offeror's selling process.

14. Offeror might mitigate that problem by offering a break-up fee to Offeror's Purchaser if Offeree exercises its ROFR and "takes the deal" that Offeror's Purchaser negotiated. Of course, Offeror's Purchasers don't invest time and trouble in pursuing transactions just to recover a break-up fee. In a market full of other opportunities, they may go look at other, less "hairy," opportunities instead. If an Offeror's Purchaser does earn a break-up fee, should Offeree agree to bear part of that fee? If so, might it make sense to allow Offeree to make a "standing offer" for Offeror's Interest to define a floor for future sales? This sounds great but could create its own complexities. As the best solution to those complexities and the others this article describes, perhaps Offeree and Offeror should, as a practical matter, just try to maintain a good relationship and good lines of communication. If Offeree wants to buy Offeror's Interest, Offeree should feel free to make an offer at any time.

15. When an Offeror dips its toe into the marketplace, though, it should try not to stub its toe by accidentally triggering the ROFO. Some ground leases give an Offeree the right to buy if an Offeror "decides to sell," with no objective or bright-line definition of what that means or how to measure the state of Offeror's mind. If Offeree were to engage a psychic to delve into Offeror's innermost thoughts, Offeree or Offeree's psychic could say Offeror's inquiries in the marketplace evidenced a decision to sell, triggering the ROFO. Offeror, of course, will want to avoid any unintentional triggering of a ROFO and will want to stay away from psychics. But does (lack of) physical proximity make a difference when dealing with psychics? That may be the subject of a future article.

16. A ROFO results in more time between the First Right Notice and the closing than would a ROFR. That delay can create additional problems for an Offeror if the marketplace pricing for Offeror's Interest is volatile. For example, leased fee estates involving corporate credit ground lessees often trade much like bonds. Pricing can change dramatically in a short time based on small changes in interest rates or the ground lessee's credit rating. If a ROFO (or, to a lesser degree, even a ROFR) requires Offeror of the leased fee estate to specify a fixed dollar price in the First Right Notice, Offeree (here, the corporate credit ground lessee) may get the best of both worlds if interest rates move in the "wrong" (or "right") direction. Use of a ROFR rather than a ROFO shortens the process, which mitigates but does not eliminate the problem. Offeror may want the right to specify in the First Right Notice a pricing formula tied to interest rates and other variables on the closing date, rather than the fixed dollar price required by traditional First Rights language. Similar issues arise in any period of unusually fast appreciation or the bubble bursting that sometimes follows.

17. The ground lease should prohibit any sale transaction at all unless Offeror has given a First Right Notice, subject to a few exceptions such as affiliate transactions and foreclosures. That sounds easy but many First Right clauses get it wrong. For example, a ROFR often arises only if, in the words of the ground lease, Offeror "receives an offer that it intends to accept." If instead Offeror communicates an offer to an Offeror's Purchaser and Offeror's Purchaser then accepts Offer, that sequence of events does not satisfy the express conditions under which Offeree would actually have a ROFR, because Offeror did not "receive" an offer that it wanted to accept. Offeror could then go ahead and sell, free of the First Right. Sometimes a ground lease requires a proposed sale to satisfy certain criteria (such as all cash, no other real property involved, a deposit of at least a certain amount, and no due diligence period), before any ROFR actually arises. The ROFR would not apply at all if, for example, Offeror proposed to take back a small mortgage. Finally, in many cases, an Offeror can sidestep any First Right obligation by structuring the transaction as a sale of the equity interests in Offeror rather than as a sale of Offeror's Interest. In my experience, many First Rights disregard equity sales. On the other hand, if a First Right does apply to equity sales, then any equity investor contemplating a sale of its equity may need to contend with two First Rights—one under the ground lease and perhaps another under the JV. Attempting to properly analyze and align those two First Rights creates almost endless new opportunities for mistakes, practical problems, issues, and litigation. Of course, we have nothing to worry about because smart lawyers can always figure everything out perfectly. *See, e.g.*, Joshua Stein, *It's Complicated, But Is It Right?*, THE MORTGAGE OBSERVER, at 12 (2013), http://www.pdf2go.org/100006.html.

18. Offeree will want to make sure Offeror always has Offeree's correct address. If Offeree moves, it should remember to notify Offeror of Offeree's new address. When a party moves, how often does it actually remember to formally notify all its counterparties of the move, in a way that complies with the specific requirements of each of its contracts?

19. In the case of a ROFO, does Offeror have to go through the ROFO process before negotiating or signing an Offeror's Contract? Or can Offeror first sign an Offeror's Contract, but make it entirely subject to subsequent compliance with the ROFO? Depending on the wording of the ROFO, Offeree might argue that Offeror must go through the process sequentially, so Offeree gets a clean first bite before anything else happens. In that case, if Offeror signs an Offeror's Contract before sending the ROFO Notice, then at best that might invalidate the ROFO Notice, and at worst the whole exercise might constitute a default under the ground lease. The validity of this argument would depend entirely on the precise words of the First Right and how a court interpreted them.

20. If an Offeror actually triggers a First Right, particularly with no warning, it often signals that the relationship between lessor and lessee has reached a point where the parties cannot amicably negotiate a satisfactory exit or restructuring that makes sense to both of them. A First Right is supposed to encourage the parties to work together to do exactly that. No one should ever actually have to exercise any First Right. When someone does, it's often a prelude to a fight. In that fight, Offeree may want to engage new counsel to ensure Offeree receives objective advice on whether the First Right was negotiated and documented appropriately. Offeree may fear that the lawyer who negotiated and documented the First Right may not

tell Offeree if the First Right was badly written—and many of them, probably most of them, are very badly written indeed. The same dynamic comes into play whenever any transaction starts to head toward litigation.

21. Real estate investors with substantial liquidity in the form of cash or large revolving credit lines—REITs, for example—may be the ones most likely to benefit from First Rights. Conceivably, to make First Rights useful for less liquid Offerees, one could also build in a requirement for Offeror to provide short term purchase-money financing to help Offeree close, after which Offeree would still need to arrange new financing reasonably soon. I have not seen such provisions, however, probably in part because they contemplate continued entanglement between parties who were supposed to become less entangled through the First Right mechanism. As a variation, perhaps the First Right could give Offeror a choice between offering purchase-money financing and allowing Offeree an extended response period for any First Right Notice.

22. Ideally, the mortgage that already encumbers Offeror's Interest will include the lender's pre-approval of a conveyance to Offeree if Offeree exercises a First Right. If an Offeree has perfect and complete foresight and all the time in the world, it might even consider requiring Offeror to include such a pre-approval in any such mortgage. But even if Offeror's loan did include such a pre-approval, how likely is it that Offeree's tastes in mortgage financing match Offeror's? First Rights granted between members of a JV raise similar issues. There, the JV agreement will often try to assure that the JV's lender pre-approves any transfers between the joint venturers, by exercise of a First Right or otherwise.

23. Perhaps Offeree should ask for the ability to exercise the First Right, but with no obligation to close unless Offeree obtains a mortgage (i.e., a mortgage contingency). Conditions of this type are rarely seen in any commercial purchase and sale transactions.

24. For a discussion of the many ways an Offeror, an Offeree, or anyone else giving a notice can do so incorrectly, see Joshua Stein, *A Checklist For Giving Legally Effective Notices*, THE PRACTICAL LAWYER, August 2005 at 12. *See also* Joshua Stein, *Good Faith and Fair Dealing in Optionland*, 25 SHOPPING CTR LEGAL UPDATE 14 (2005), discussing *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Ctr. Assoc.*, 864 A.2d 387, 395 (2005). (optionee forgot to include required check with exercise notice; implied covenant of good faith and fair dealing required optionor to tell optionee about the mistake).

25. Of course, parties who expect to receive notices do care about compliance with notice clauses, if only to assure that notices get to the right place at the right time without going astray. Too much judicial kindness to imperfect givers of notices may lead to unpleasant surprises for the recipients of imperfectly given notices.

26. The First Right language will usually say that 30 days of silence constitutes a waiver. Does that automatically cure Offeree's default, if any, by failing to respond? Will Offeror want to rely on a deemed waiver? Will Offeror's Purchaser? Its lender? A title insurance company?

27. An Offeror should look ahead to the closing with Offeror's Purchaser and the need for Offeror's Purchaser to obtain title insurance. The title insurance company will probably demand a high comfort level that Offeror complied with the First Right and Offeree's rights lapsed without exercise. Hence the likely need for a written confirmation from Offeree. Even if the ground lease doesn't directly require such a confirmation, Offeror may be able to rely on language in the ground lease about estoppel certificates—though that may take a while. If Offeror can't give the title insurance company 100% comfort about the First Right, the title insurance company will probably demand an indemnity from a creditworthy party—forcing Offeror or its principals to bear some level of continuing liability and risk for a transaction that should have become purely historical with a clean exit.

28. Offeree might agree in a side letter to: (a) provide that confirmation if asked; and (b) enter into a similar side letter with the next Offeror if Offeree does not exercise its First Right. Side letters raise problems of their own, though, starting with the fact that they often get lost.

29. *LIN Broad. Corp. v. Metromedia, Inc.*, 74 N.Y.2d 54, 63, 542 N.E.2d 629, 634, 544 N.Y.S.2d 316, 321 (1989); distinguished from *Henderson v. Nitschke*, 470 S.W.2d 410, 414 (Tex. Civ. App. Eastland 1971) (First Right Notice gave Offeree irrevocable option, exercisable until Deadline even if Offeror withdrew First Right Notice).

30. If the parties do not attach a form of contract to the ground lease, then the First Right should perhaps provide for negotiation of the contract only if and when Offeree has actually exercised its First Right, perhaps with a "baseball arbitration" mechanism to resolve any possible deadlock. That approach creates its own risks and problems.

31. If Offeree is the lessee under a ground lease and Offeree's default under a First Right also constitutes a ground lease default, then the ground lessee's leasehold mortgagee will worry about the possible need to cure a hypothetical future default whose magnitude or cost the leasehold mortgagee cannot predict. Although there are ways to give the leasehold mortgagee comfort, those measures can create their own issues. One can easily avoid the issue by treating a ground lessee's default under a First Right as something entirely independent from the ground lease.

32. In a ground lease of the Roosevelt Hotel in Manhattan, Schedule B listed matters of record against the ground lessor's title. The ground lease also gave the ground lessee an option, not just a First Right, to acquire the ground lessor's leased fee estate, at a fixed price, subject to "only the matters set forth in Schedule B." That schedule listed some fee mortgages, all prior to the lease. The ground lessee claimed credit against the purchase price for the amounts due under those mortgages. The ground lessor claimed the ground lessee owed the full cash purchase price, and also had to take subject to all the mortgages. The trial court held: "the lease purchase option establishes a fixed, all-inclusive purchase price...free from any additional mortgage obligations." *Roosevelt Hotel Corp., N.V. v. Letoh Assoc.*; Court Decisions; First Judicial Department; Supreme Court; New York County, 223 N.Y. L.J. 5 (2000), *aff'd*, 282 A.D.2d 380, 723 N.Y.S.2d 653 (App. Div. 2001). The parties could have avoided several years of litigation by more carefully defining the scope of permitted title exceptions, and not assuming that permitted title exceptions should always be permitted.

33. Other smart lawyers can later figure out ways to get around them. And then smart litigators can spend months digging through email looking for the smoking gun.

34. An Offeree will more likely want to convert Offeror's transaction into an outright sale of the property in the case of a First Right within a JV agreement, as opposed to a First Right in a ground lease. In the context of a ground lease, leasehold and leased fee estates trade regularly and are a known quantity. Investors know how to analyze them and what they entail. In contrast, JV interests vary widely and entail a closer relationship with a possibly unknown counterparty. Thus an Offeree will probably have more trouble finding a buyer for just a JV interest in a property-owning entity, and will probably face a substantial "minority interest discount." Offeree's best execution of a "flip" of a JV interest seems more likely to require Offeree to include its own interest in the property. There, an Offeree may want the right to convert its exercise of the First Right into the JV's sale of the entire property to a third party. Even in a ground lease, though, Offeree could conceivably decide that the best possible flip would include Offeree's interest in the property.

35. Answer: all is fair in love and real estate. And in the world of First Rights, it is particularly hard to figure out where fairness and justice end and opportunism and abuse begin. Moreover, even if an Offeror wants to sell its Interest at one price, it still might want to buy both parties' Interests—the whole thing—at

some higher price, especially if Offeror and Offeree have not played well together and the transaction would allow Offeror to get rid of Offeree. If a First Right arises in a JV, an Offeree's quick profitable "flip" might, in Offeror's mind, constitute actionable trickery. *See Blue Chip Emerald LLC v. Allied Partners Inc.*, 299 A.D.2d 278, 279, 750 N.Y.S.2d 291, 294 (1st Dep't 2002) (LLC member bought out other members, soon resold at huge profit; buyer's superior knowledge meant disclosures and waivers could not overcome perceived breach of fiduciary duty), *abrogated by Centro Empresarial Cempresa S.A. v. America Movil, S.A.B de C.V.*, 17 N.Y.3d 269, 952 N.E.2d 995, 929 N.Y.S.2d 3 (2011). *See also* Steven Simkin & Manuel E. Lauredo, *Wearing Two Hats at Once: Buyout Transactions Between Real Estate Joint Venture Partners*, 32 Real Estate Rev. 5, 7 (Winter 2004) ("The duty to fully disclose should cease when the parties become adversarial, in order to prevent the alleged fiduciary from occupying conflicting roles....Well-drafted waivers and disclaimers should be given effect[.]"). *But see Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V.*, 17 N.Y.3d 269, 279, 952 N.E.2d 995, 929 N.Y.S.2d 3, 10 (2011) ("Where a principal and fiduciary are sophisticated parties engaged in negotiations to terminate their relationship...the principal cannot blindly trust the fiduciary's assertions.").

36. What constitutes a third-party transfer that would trigger a First Right? What about transfers between related entities? Does execution of a contract of sale evidence a third-party offer? Any First Right should answer those questions and others. Though the answers may seem obvious, questions like these trigger a remarkable amount of litigation. As one example, in *Hartzheim v. Valley Land & Cattle Co.*, 153 Cal. App. 4th 383, 393, 62 Cal. Rptr. 3d 815, 822-23 (6th Dist. 2007), the court needed to figure out whether a particular transfer constituted a bona-fide third party offer, which would trigger a First Right. The court applied a three-prong test in deciding what those words meant. The court looked at: (1) the terms of the contract, which said certain circumstances triggered the First Right; (2) whether Offeror's transaction was entered into at arm's length and involved a change of control of the property; and (3) whether Offeror had tried to defeat the ROFR. Based on those three considerations, the court decided that a particular transaction did not trigger a First Right, because it did not result from arm's-length dealing, did not result in a change of control, and had legitimate tax planning purposes. The result seems reasonable, but demonstrates the issues that can arise in testing whether particular circumstances trigger a First Right.

37. According to one decision, an Offeror's decision to include other property in a contemplated transaction does not, in and of itself, defeat a First Right. Offeree can instead insist on receiving a First Right Notice covering only the property subject to the First Right. *K.S. & S. Rest. Corp. v. Yarbrough*, 104 A.D.2d 486, 487-88, 479 N.Y.S.2d 235, 237 (2d Dep't 1984).

38. *383 Madison LLC v. Bear Stearns Cos., Inc.*, No. 601570/08, N.Y. Slip Op. 33409(U) at 6, 2008 N.Y. Misc. LEXIS 9581, at 8 (Sup. Ct. N.Y. Cnty. Dec. 18, 2008).

39. A lender will probably also want to assure that the First Right goes away forever if Offeror ever loses its Interest through foreclosure. Without clear language on point, a foreclosure exclusion from a First Right may not eliminate the First Right permanently after a foreclosure, thus potentially discouraging bidders. That potential will concern prospective mortgage lenders to Offeror. Thus, a First Right will usually: (a) exclude foreclosure sales; and (b) go away permanently if Offeror loses its Interest through foreclosure. As a compromise, sometimes the "foreclosure sale" exclusion will also extend to the first sale after the foreclosure sale, and then the ROFO will apply again to future sales.

40. At a suitable time, Offeree might want to be proactive and reach out to Offeror's lender to request notice in the case of any foreclosure sale or adjournment, even if the lender does not contractually agree to give that notice. In practice, the lender might welcome Offeree's interest, fearing claims from Offeror if the lender tells a likely bidder to get lost. On the other hand, Offeror might see it as meddling and a breach of etiquette, so Offeree might want to ask Offeror to consent to such communications in advance. California law gives anyone a statutory right to record a "request for notice" of a trustee's sale. Cal. Civ. Code § 2924b(a) (West 2014). The party conducting the sale must comply with that request. Cal. Civ. Code § 2924b(b)(2) (West 2014). An Offeree may want to exercise any such right that might be available. An Offeree could also buy the loan or figure out a way to hold some recorded interest in the property subordinate to the mortgage, e.g., a notice of the First Right, if the lender will tolerate that.

41. This is an example of a nonstandard assurance that an Offeror may want to incorporate into future estoppel certificates. When the parties negotiate the estoppel certificate clause of the original ground lease, they may not think of requiring this assurance, though. It demonstrates the benefits of including "catch-all" language stating that estoppel certificates must include other assurances reasonably requested in the future.

42. Offeree might also propose that, under these circumstances, the First Right language should give Offeree some substantive improvement in the deal, such as a low single-digit percentage discount in the unlikely event that Offeree exercises its First Right and actually buys Offeror's Interest. A thoughtful Offeree might ask for such a discount in any event, as compensation for the burdens of dealing with a First Right Notice. Such a discount would also incentivize Offeror not to send a First Right Notice, and to negotiate a more collegial resolution. I have never seen such a discount in any First Right; nor have I seen it in any buy-sell clause in a JV, where it seems even more appropriate. Would such a discount create bad incentives? Probably not. As a similar thought, perhaps under some circumstances Offeror should agree to reimburse Offeree's legal fees of dealing with any First Right Notice, or vice versa.

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