

Rights Of First Refusal and Rights Of First Offer in Commercial Leases from a Landlord's Perspective

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A landlord should carefully consider the business and legal implications of granting the tenant a preemptive right to purchase the building in which the leased premises are located, or to lease additional space adjacent to the leased premises. These rights are commonly structured as either a right of first refusal ("Right Of First Refusal"), or a right of first offer ("Right Of First Offer"). As the inclusion of such rights in a lease may ultimately affect a landlord's ability to negotiate future leases or even the sale of the property, it is important for landlords to know the relative benefits and disadvantages associated with each.

Comparisons

A Right Of First Refusal requires that in the event the landlord receives an offer to lease or purchase (as applicable) the property from a third party that the landlord is willing to accept, then the landlord must submit this offer to the tenant, who then has the right to lease or purchase the subject property on the same terms and conditions as set forth in the third party offer. Only if the offer is rejected by the tenant, or the tenant fails to timely respond to the offer, may the landlord then proceed with the lease or sale of the subject property to the third party in accordance with the terms of the offer. In contrast, the Right Of First Offer requires that prior to marketing the property, the landlord must give notice to the tenant that a subject property is being made available for lease or purchase on the terms set forth in the landlord's offer, and that the tenant has the right to lease or purchase the property pursuant to that offer by giving the landlord notice of its election.

From a landlord's perspective, the Right Of First Refusal has several disadvantages as compared to the Right Of First Offer, with one of the most important being that a Right of First Refusal tends to have a "chilling effect" in generating potential tenants or buyers for a property which the landlord is interested in leasing or selling. Third parties are often wary of expending time, energy and costs in negotiating a potential deal if an existing tenant may ultimately step in, exercise its rights and reap the benefits of such negotiations. Thus, a Right Of First Refusal may diminish the pool of potential buyers and/or tenants, which may ultimately result in a lower purchase price or less rent.

Another drawback to the use of a Right Of First Refusal relates to the potential weakness of the landlord's bargaining position with the tenant. While the landlord maintains a relatively strong position under a Right Of First Offer since it may offer the subject property on its own price and terms, the terms and conditions of the offer presented to the tenant under the Right Of First Refusal may be the result of negotiations between the landlord and the third party, which ultimately flow to the benefit of the tenant if the tenant elects to exercise its right under the Right Of First Refusal. Such terms and conditions may be less favorable than the landlord would have otherwise been able to negotiate with the tenant absent a Right Of First Refusal.

However, a Right Of First Offer may also limit the landlord's flexibility and leverage when a landlord intends to sell or lease the subject premises. Quite often, a Right Of First Offer will provide that

if an offer has been provided to the tenant and rejected, it must nonetheless be resubmitted for tenant's consideration if certain aspects of the offer are thereafter changed. Often concessions are made in the negotiation process and to the extent such concessions trigger the landlord's obligation to resubmit the Right Of First Offer to the tenant, such concessions will inure to the benefit of the tenant, thus resulting in the Right Of First Offer becoming a *de facto* Right Of First Refusal. A landlord can eliminate this concern through careful drafting by providing that the landlord is not required to resubmit an offer, once rejected by the tenant, except for specific threshold changes (such as a price reduction by more than "x" percent). This will allow the landlord flexibility to make concessions if it desires without retriggering the Right Of First Offer.

Conclusion

A landlord should be hesitant to routinely grant a tenant either a Right Of First Offer or a Right Of First Refusal under a lease as any such right could impede the landlord's ability to market the property and the resulting delay could result in negative consequences. If a landlord is inclined to grant such a right to a tenant, in most instances the landlord should insist on giving a Right Of First Offer as opposed to a Right Of First Refusal since the Right Of First Offer typically gives the landlord much greater control and does not have the same "chilling effect" as the Right Of First Refusal. Regardless of whether a Right Of First Offer or a Right Of First Refusal is granted, the relevant provision must be carefully drafted to ensure that it not only reflects the intent of the parties, but also protects the landlord's interests by clearly setting forth the conditions that must occur in order to trigger the tenant's rights, and the steps that must be taken by tenant in order to timely exercise those rights.

Angelo & Banta, P.A. routinely counsels and assists landlords in drafting and negotiating lease agreements, including analyzing whether the inclusion of preemptive rights is appropriate. For more information about the firm's Real Estate practice group, please contact Gavin S. Banta at: gsb@angelolaw.com.

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