ACREL News

President's Message

The first item to note is our successful Spring Mid-Year meeting at the Westin Rio Mar in Rio Grande, Puerto Rico. We were blessed with good weather, a superb program, and an excellent turnout, especially in light of the current economic conditions. It was certainly good to get together with our Fellows, and those who were able to attend enjoyed the location and the program.

In keeping with our theme of adding value to the Fellows, on Tuesday, June 16th, the College sponsored a call-in seminar, "Government Regulatory Actions and Programs, Loan Workouts and Asset Acquisitions in a Multi Tranche World". The program was organized by Earl Segal and Larry Wolk, and Larry did a superb job of defining the topic, making his presentation, and arranging for two other excellent speakers, Melissa Vanouse from the Federal Reserve System and David Iannarone, the President of CW Capital Asset Management, to participate in the presentation. 210 Fellows called in, and there were multiple participants on many of the calls, reflecting the College's "open" policy of letting our colleagues listen in to our call-in programs. It is a tribute to the expertise we have in the College that we were able to present a timely program covering a critical subject at no cost to our Fellows. We all owe a great deal of thanks to Larry and to Earl for their efforts in organizing and delivering this program. We would also appreciate your feedback about the program and ways we can improve going forward.

Howard Steindler has volunteered to form a committee to review and better define the mission of the ACREL Foundation. Ken Jacobson has agreed to be the liaison from the Board and Howard is in the process of contacting potential committee members. The committee will analyze what sorts of programs, services and opportunities the ACREL Foundation might provide to our Fellows. We would appreciate your ideas as to how we might better frame the Foundation's mission and activities.

We are heavily into preparation for our annual meeting at the JW Marriott in Washington, D.C. from October 29, 2009 to October 31, 2009. Messages about programs, tours, and social gatherings will be forthcoming in

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President's Message

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the near future and, as always, will be posted on the website for your perusal. Meg Meister and the Programs Committee have come up with an excellent program involving a combination of interesting outside speakers and College Fellows. As an experiment, at this meeting the substantive committees have been allotted time on the program to make presentations to the full College. We will have presentations by four of our substantive committees: Title Insurance, Insurance, Common Interest Ownership, and Capital Markets and Finance, and the Fellows will be able to pick the particular program which is of most interest to them. This experiment was initiated following requests from various of the substantive committees for more time at our meetings to put on programs within their specific areas. We will be very interested in your feedback on this aspect of the program – if it is something that the Fellows like, we will continue it at future meetings.

Another exciting aspect of the College's business is the admission of 27 new Fellows. The Executive Committee has contacted each new Fellow to welcome them to the College and to encourage them to become involved in various College activities, including one or more substantive committees, and the committee chairs have likewise been following up with the new Fellows to encourage their involvement. Continuing a process begun last year, the Executive Committee is also in the process of contacting all of the spouses of our new Fellows to welcome them to the College and answer frequently asked questions about the College and how our Meetings are arranged and conducted.

I hope each of you will be able to attend the Fall meeting in Washington. Although the times are difficult, the value that the College is able to give to its Fellows is outstanding, and one of the best ways to realize that value is by attending. Until then, have a great Summer.

Best regards.

Phil

Philip D. Weller, President

STAFF BOX

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One Central Plaza
11300 Rockville Pike, Suite 903
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Meetings Calendar

2009 Annual Meeting
October 29-November 1, 2009
JW Marriott
Washington, DC

2010 Mid-Year Meeting
March 11-14, 2010
Terranea Resort
Palos Verdes, CA

2010 Annual Meeting
October 7-10, 2010
Four Seasons
Toronto, Canada

ACREL Phone Seminar a Success

by Earl Segal, Newmark Knight Frank, Washington, DC

Demonstrating that there is no summer vacation for ACREL's services to its Fellows, on June 16th an estimated 500 participants around the country gathered by their phones to take advantage of ACREL's most recent telephone presentation. The timely program, Government Regulatory Actions and Programs, Loan Workouts and Asset Acquisitions in a Multi Tranche World provided ACREL Fellows and their invited colleagues the opportunity to listen to three informative presenters describe their perspectives on a rapidly changing area of interest to many.

Joining ACREL Fellow and program leader, Larry Wolk, was Melissa Vanouse from the Division of Banking Supervision and Regulation of the Board of Governors of the Federal Reserve System, as well as David Iannarone, president of CW Capital Asset Management. Mr. Iannarone shared with the audience suggestions on how to effectively gain the attention of and deal with special servicers, bringing to the conversation the perspective of a special servicer with over $170 billion in assignments. Ms. Vanouse provided thoughtful insight into the ever changing role of the Federal Reserve System.

The program, provided free of charge, sought to bring ACREL fellows together with articulate experts in the field. As a further service to ACREL Fellows a recording of the presentation was made, which recording may be accessed on the ACREL website, from the "webinars" tab.

Many thanks to Larry for making the program the success that it was. ■

Hotels, Resorts and Hospitality Committee

In late 2008, ACREL's newest substantive committee, "Hotels, Resorts and Hospitality Committee" was formed, with Bill Weber and Jim Wright as the co-chairs. This Committee now has approximately 89 members and will hold its initial meeting at the Fall ACREL meeting in Washington, at which time its goals will be discussed and established.

The Committee's webpage currently contains a mission statement, a list of members, and a bibliography of articles and cases involving hotels, updated annually by Jim Wright.

If anyone who is not currently a member of this Committee would like to join, please contact Bill or Jim. Bill's e-mail is weber@hugheshubbard.com; Jim's is jdwright@venable.com. ■

Planning Validated in Recent Tax-Court Case Concerning Golf-Course Conservation Easement

by William R. Sylvester, Walston Wells & Birchall, LLP, Birmingham, AL

The June 22, 2009, decision in *Kiva Dunes Conservation, LLC* (T.C. Memo. 2009-145), highlights the importance of planning in connection with conservation easements. The result (barring an appeal by the IRS) is a $28.5M deduction, allocable among E. A. Drummond ("Drummond"), his wife, and members who were admitted on December 29, 2002, two days before a conservation easement (the "Easement") was granted to the North American Land Trust ("NALT"). What follows is a synopsis of the tax strategy, a review of the trial and opinion, and a look at lessons learned from *Kiva Dunes*. The outcome was a resounding victory for the taxpayer, which signals a clear line between "proper" and "improper" deductions. The release of the opinion, as temperatures in Alabama reach the 100 degree mark, brings a truly refreshing atmosphere to those of us in the conservation world.

Planning the Transaction

We had not represented Drummond when our firm was retained to plan the Easement. We had worked with conservationists and owners and developed a reputation for expertise with the tax rules concerning both partnerships and charitable deductions. Since Drummond could not take a $30.5M deduction in 2002 (he would need a "contribution base" of some $90M!), our charge was to structure a transaction whereby new partners would share. A newly formed LLC would be created ("Kiva"), to receive the conveyance of the golf course (the "Property"), and lease it back, on acceptable and defensible terms, to D&E Investments, LLC ("D&E") the owner of the golf course and residential resort community since 1995.

The applicable sections in the Internal Revenue Code were well known to us: (1) Section 1223(2) (carry-over basis), as it relates to Section 170(e)(1) (charitable contribution limited to basis, unless gift is of a "capital" asset); (2) Sections 706(c) and 708(b)(1)(B) (closing of the partnership books, upon termination of partnership, giving new partners a "full share" of the charitable deduction); and (3) Sections 702(a)(4) and 704(d) (charitable contribution is a "separately stated" item, not subject to basis limitations). We did not opine about the conservation purposes served by the Easement, or the appraisal. Drummond was working with NALT, and with Claude Clark, who has decades of experience in appraisals in Baldwin County, Alabama.

The Ground Lease was the principal area of concern to us. It was effective January 1, 2003. The term was five years, with an additional 20 years of extension options, at escalating base rentals and percentage rent. D&E had a continuing option to repurchase the Property at fair market value "taking into account the terms and provisions of the Conservation Easement and such other conditions and factors as are relevant." With these elements in place, Drummond conveyed 61% of Kiva to 10 new members on December 29, 2002. All were either family members, or long-time employees. (The trial record does not disclose the dollar amounts paid by each of the new members, but commonly conservation interests were priced at 20-25% of the deduction).

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Abusive Conservation Promoters and Rogue Land Trust

The acreage under conservation with local and regional land trusts doubled between 1998 and 2003. There was a growing public awareness of the tax benefits associated with qualified conservation easements. Starting in the spring of 2003, *The Washington Post* ran a series of articles concerning The Nature Conservancy, its "conservation buyer" transactions, and other promoters who were offering questionable deals involving flood plains, sloping hillsides and other unusable acreage. The Senate Finance Committee held hearings in June, 2004 about potentially abusive easements. There followed an article by Nancy A. McLaughlin in the September/ October 2004 issue of Probate and Property, entitled *Questionable Conservation Easement Deductions*, 18-OCT Prob. & Prop. 40, 43, which spoke of "rogue" land trusts, and an article in the October 11, 2004 edition of Tax Notes on *"Proper and Improper Deductions for Conservation Easement Donations, Including Developer Donations"*. With this "guilt by association" it was no surprise that the government issued a Notice of Final Partnership Administrative Adjustment ("FPAA") on April 11, 2006. The FPAA proposed an adjustment of $30,623,235 to Kiva for its 2002 tax year.

Trial and Judgment

The Tax Court trial was held in early 2008, in Birmingham, Alabama. Kiva put on multiple witnesses and exhibits to demonstrate that the Easement met one or more of the necessary conservation purposes. (The government subsequently conceded this with a single sentence in its Opening Brief.) The remaining issue was the valuation of the Easement. Kiva used Claude Clark once more. The government's expert was Philip Paulk.

Each of the appraisers said that the highest and best use of the Property before the Easement was the development of a residential, single-family subdivision. Clark and Paulk also determined the "before" value by discounting the net present value of projected costs and income attendant to such a hypothetical development. The "before" values differed by $20M ($31.9M and $10M), due to the fact that Clark and Paulk made significantly different assumptions about: (1) the number of lots that could be developed on the Property (370 versus 300); (2) the average lot price ($170,000, as opposed to $85,000); and (3) the "absorption period" required sell out of the lots (10 years, as compared to 15). In each case, the more "conservative" figure was Paulk's.

Clark and Paulk used different approaches for the "after" value of the Property. Paulk "capitalized" an erroneous figure (allegedly, the course's 2002 net income), to arrive at an "after" value of almost $9M. (The Property actually lost money in 2002). Clark's testimony was that the "economic health" of the Property would not justify an "income" approach. He used a comparable sales analysis, choosing a number of unimproved tracts that could be used for recreational purposes. After adjusting the various comparables for features like location, access, visibility, size, availability of utilities, topographical conditions and wetlands characteristics, Clark arrived at an "after" value for the Property of approximately $1M. Considering the "before and after" figures of Clark and Paulk, respectively, the allowable deduction differed wildly - $30.9M by Kiva's expert and $1.21M by the government's expert.

In sorting out the wide disparity between Paulk and Clark, Judge Wills first observed that "Paulk has no particular expertise in Baldwin County, and he has been to the Baldwin County, Alabama, area only twice in

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connection with his appraisal of the Easement." He then reviewed the evidence presented by the appraisers and found: (1) 370 lots could be developed on the Property, as supported by the testimony of the Director of the Baldwin County Zoning Board; (2) Clark's analysis concerning lot prices was persuasive, and Paulk's values were based on only two interior lots; and (3) the 10- year absorption period used by Clark was reasonable, while Paulk's absorption rate was based on the sale of homes, when lots could have sold out more quickly. Refusing to "split the baby" like King Solomon, the Court assigned a "before" value to the Property consistent with Clark's testimony. The Court placed no reliance on Paulk's "after" value either since he used erroneous data, while admitting that he was provided D&E's 2002 income tax (?) return before submitting his appraisal. The government's lone relief was the ruling that the "after" value should be increased to reflect an improved golf course, instead of raw land. The final value of $28.6M for the Easement was a remarkable result, given a golf course operating in the red.

Lessons Learned for the Future

Some six and one-half years after Kiva took its deduction, we have a long awaited opinion sustaining 94% of the amount claimed. What might be learned from this?

- No partnership provisions were addressed in the trial or opinion. *Kiva Dunes* is not clear precedent for the steps that were used to allocate charitable deductions to partners who were "late year admittees". The government could seek to disallow deductions in a case like this under Regulation Section 1.701(2) (partnership anti-abuse rules), by arguing that newly admitted members do not hold "real" partnership interests, by challenging the terms of the lease, or on other grounds.

- Very few taxpayers have the resources of the Drummond family. The IRS could audit every conservation easement, settling for 50% to 75% of the claimed deduction, regardless of the conservation purpose served and the quality of the appraisal. (The IRS is in fact in the process of acquiring additional information on conservation donors, through requests that appraisers produce names and reports for 2003 to date).

- The IRS and appraisers could establish more refined parameters, designed to realistically distinguish "proper" and "improper" conservation deductions. In appropriate (i.e., "grossly abusive") valuations, members of the American Society of Appraisers might even offer their services to the IRS!

- There could be legislative activity governing the "same-year monetizing" of otherwise qualified easements.

From all indications, the outcome in *Kiva Dunes* will see a resurgence of conservation easements. Certainly, legitimate easements were not pursued, in recent years, due to unfounded criticism and IRS attacks. It will be interesting to see how "good" appraisers reflect market conditions in today's valuations. One might expect depressed "before" values, based on assumptions of lower unit prices and longer absorption periods. Nevertheless, given a proper combination of substantial conservation purposes and strong real estate values (for specialized market segments) the qualified conservation easements could prove to be very popular again. ■

A Brief Lexicon for Troubled Loans

by Joshua Stein and Obianuju A. Enendu[1], Latham & Watkins, LLP, New York

For over a decade, the commercial real estate industry used phrases like proceeds, sizing, trophy property, debt stack, capital stack, lease-up projections, cashing out, subordination levels, and other terms born of optimism and securitization. Today, the commercial real estate financing industry is learning a new vocabulary: the vocabulary of troubled loans. Actually it is an old vocabulary, one that many thought the industry would never need to use again. They were, of course, wrong.

Some of the phrases of real estate distress are just descriptive. Others are metaphors or slang that carry some cynicism and humor along with them. Some of these phrases are even funny, with meanings not obvious to the uninformed ear. By fully understanding these phrases, one can begin to understand how borrowers and lenders think about and deal with troubled real estate. The lexicon that follows collects some of these phrases – phrases you will never see in legal documents, but will often hear in negotiations, meetings, and industry events.

The authors offer no guarantee about this lexicon, except that it is incomplete and imperfect. It comes from a more general lexicon of commercial real estate financing – not just distressed loans – that the authors published in the March/April 2009 issue of the American Bar Association's Probate & Property magazine. For a copy, visit www.real-estate-law.com and click on "Defaulted/Distressed Loans."

TERM	DEFINITION
Bad Boy Carve-out	A risk or source of liability for which a borrower's principals may assume personal liability under a Carve-out Guaranty.
Bid-Out	A strategy where multiple foreclosure bidders agree to let one of them acquire the collateral with a low bid, then resell it at a second auction just within the group, with the increase in price being split among the multiple bidders. Often a crime.
Bow-Tie Loan	Modification of an existing loan in distress, deferring interest that accrues above a pre-determined interest rate. A Bow-Tie Loan rolls any deferred interest due into the loan principal.
Carve-out Guaranty	A guaranty of certain risks for which a lender refuses to look solely to the collateral. Also sometimes a contingent full guaranty of the loan, to discourage the borrower from doing certain bad things (e.g., a voluntary or collusive bankruptcy). These matters are all "carved out" from the otherwise nonrecourse nature of the loan, giving the lender access to the other assets of the guarantor(s). Of little value, unless signed by a Warm Body. See also Bad Boy Carve-out.

[1] Joshua Stein is a partner in the New York office of Latham & Watkins LLP (www.lw.com). He chairs the Mortgage Bankers Association of New York Education Committee (www.mbany.org) and is a member of the American College of Real Estate Lawyers. Obianuju A. Enendu is an associate in the New York office of Latham & Watkins.

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TERM	DEFINITION
Cash Sweep (or Cash Trap)	Procedure in which excess cash (beyond operating costs and debt service) goes into a lender-controlled account. Often activated by the borrower's failure to meet a financial test and accompanied by a Lockbox.
Chilling a Sale	Actions taken at a foreclosure sale to suppress bidding, so a favored bidder can buy below market. See also Bid-out.
Deep Pocket	A person with extensive cash or immediately marketable securities.
Deep Pocket and Short Arms	A person with extensive cash or immediately marketable securities who is also very good at not using that cash or those immediately marketable securities.
Dialing for Dollars	Looking for a lender and trying to negotiate the best deal.
Doctors and Dentists	Many small investors in a real estate deal and potential plaintiffs if the deal goes bad. Often team up with lawyers who don't follow their own advice.
Go Dark	A shutdown of operations by a large store operated by a major regional or national retail tenant, often without assigning the lease or subletting the space to another operator. This shutdown can potentially damage other tenants and, in the worst case, destroy an entire shopping center fairly quickly.
Hair	Complexities, issues, and history about a particular property that create problems, delays, and extra legal fees for the closing or workout of a transaction.
Haircut	A reduction of the amount of a loan or the value of an equity investment for valuation or capital purposes.
Hope Certificate	A subordinated position (created in a Workout) that may become valuable if the world changes in a more positive way than it has changed from mid-2007 to early 2009.
Jingle Mail	When a borrower mails the keys to the property back to the lender (an informal deed in lieu of foreclosure).
Lockbox	Arrangement by which property income goes directly to a particular bank account (subject to a lender security interest) to be applied in accordance with agreed priorities for distribution of cash. Formally called cash management.
Marry Up	A lender's sale of an REO property by packaging it with some other property to increase the appeal to buyers.
Mod	Modification of an existing loan agreement.
Neutron Loan	A loan that destroys the borrower by forcing a sale of the property, while leaving the property itself intact.
Overrun (or Cost Overrun)	Amount by which the actual cost exceeds the originally budgeted, estimated, original, or targeted cost of a construction project.

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TERM	DEFINITION
REO	"Real Estate Owned" or "Other Real Estate Owned" – a category of assets on a bank's balance sheet, reserved for real estate that the bank has acquired through foreclosure or a deed in lieu of foreclosure.
See-Through Building	A finished building that does not yet have any tenant improvements or occupants and is typically in distress (or about to be). Popularized in the 1980s by Texas developers that had friendly S&L lenders.
Shill	A fake bidder at an auction, whose role is simply to increase the bids, with an understanding that the seller won't really require the Shill to buy if the Shill is the highest bidder.
Snatch Dirt	Resolution of a defaulted loan where the collateral is transferred to the lender, often through a bankruptcy.
Snorkeling	Negotiating, structuring, and closing transactions that relate to mortgages that are Under Water.
Temporary Liquidity Problem	Common explanation for financial stresses that precede a default.
Under Water	A loan whose amount exceeds the value of its collateral.
Warm Body	A creditworthy individual, as opposed to the borrower or a borrower-related entity that might sign a guaranty but has no real assets beyond the collateral itself. See also Deep Pocket.
Workout	The negotiated resolution of a troubled loan, typically but not necessarily allowing the borrower to retain the collateral, subject to the debt, for some period.
Yank a Bank	A clause in a loan agreement allowing the lender that administers a syndicated loan to buy out the interest of a syndicate member who does not behave, such as by disapproving a Workout that the rest of the group favors. Usually the pricing formula makes a Yank a Bank clause not very useful.

Options and Related Rights With Respect to Real Estate: Carveouts for Specific Transactions

by John C. Murray, First American Title Insurance Company, Chicago, IL © 2009

This article was previously published in the June 2009 Real Property, Trust and Estate Law eReport of the ABA and is used with permission.

I. Introduction

If they are not careful, the parties to legal documents creating or transferring real property interests (including leases and purchase agreements) who wish to incorporate options to purchase, rights of first refusal or similar rights, can create unanticipated problems when negotiating and drafting such provisions. Options and related rights should never be taken lightly, and should be clearly and comprehensively negotiated and drafted to reflect the intentions and expectations of the parties. The parties who have granted (and perhaps, in certain cases, those who have been granted) any option, right of first refusal, or similar rights should be careful to carve out from such rights any transactions intended to be excluded, such as: a transfer of property between a parent and a subsidiary corporation or other affiliated entities; a transfer between individuals and an LLC or a partnership formed by them of which they are the sole members or partners (as well as other forms of equity transfers with respect to other entities, such as trusts); foreclosure or deed in lieu of foreclosure; stock transfers, gifts and donations; involuntary taking of the property by government condemnation; transfers of interests between tenants in common; and portfolio or bulk sales of multiple properties (which include the property that is subject to any such right) in a single transaction. This article will review the existing case law in this area, and suggest strategies for eliminating (or at least minimizing) the problems that may occur.

II. Carveouts for Gifts

With respect to gifts and transfers of corporate stock, *see, e.g.*, *Park Station L.P. v. Bosse*, 378 Md. 122, 131-32 (2003). In this case, the court held that absent clear language in the parties' agreement to contrary, first-refusal rights did not apply to a donation of property to a charitable foundation and did not "run with the land" to bind the donee. The court stated that "courts have consistently held that a transfer of property by gift does not trigger a right of first refusal based upon a 'sale' or decision to 'sell.'" *Id.* at 131-32. *See also* 6A C.J.S. Assignments § 37 (Option contracts; rights of first refusal), which states as follows (in connection with the *Park Station L.P.,* decision, *supra)*:

> Rights of first refusal are presumed to be personal, and are thus not assignable unless the clause granting the right refers to successors or assigns, or unless the instrument clearly shows that the right was intended to be assignable. A right of first refusal to purchase real property is not assignable if the right does not run with the land but is personal to the grantee.

In *Schroeder v. Duenke*, 265 S.W.3d 843, 847-850 (Mo. App. 2d 2008), the owners of the property sold and conveyed it to the purchasers pursuant to a warranty deed. Shortly after the deed was recorded, the parties also separately executed and recorded a first-right-of-refusal document, granting the sellers the first right of refusal to repurchase the property

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upon certain terms and conditions. Several years later, the purchasers conveyed the property to their son for less than the appraised value of the property ($125,000, obtained by appraisal at the time of the conveyance to the son) without notifying the original sellers, as the holders of the right of first refusal, that they had sold the property to their son. Although it acknowledged that the transfer was not a gift (or "akin to a gift") because the son paid $85,000 for the property and financed $60,00 of the price through a bank mortgage, the appellate court denied summary judgment in favor of the holders of the right of first refusal and remanded the case for a determination of whether the son's offer was in fact a "bona fide offer" -- *i.e.*, the fair market value of the property based on the court's review of evidence to be submitted to it on this issue. The court noted that under Missouri law, a transfer of property by true gift (without any consideration) from one family member to another does not trigger a right of first refusal. For a more thorough discussion of the *Schroeder v. Duenke* case, *see* Harrison Ominsky, *Right of First Refusal – Impairing Family Gift*, 38-MAR REAL EST. L. REP. 3 (2009).

For examples of other court decisions regarding gifts (including gifts of corporate stock), *see Mericle v. Wolf and Sacred Heart Hospital*, 386 Pa. Super. 82, 88-89 (1989) (holding that all elements for a valid *inter vivos* gift were present and that transfer was not a "sale" because a "sale contemplates a vendor and a buyer and the transfer involves payment or a promise to pay a certain price in money or its equivalent." The appellate court concluded that the term "sold" should "be given its ordinary meaning, and, therefore, the appellees' transfer by way of a gift did not activate the refusal right"); *Cottrell v. Beard*, 69 Ark. App. 87, 91 (2000) (holding that right of first refusal was not triggered by grantees' transfers of their interests as gifts for no consideration, finding no ambiguity and stating that "there is no evidence here that appellees were mere straw persons through whom title was to pass on to someone else for consideration"); *Isaacson v. First Sec. Bank*, 95 Idaho 452, 455 (1973) (father's below market "sale" to son was deemed gift that did not trigger first refusal right); *LaRose Market v. Sylvan Center, Inc*., 209 Mich. App. 201, 207-08 (1995) (holding that sale of corporate stock, as opposed to sale of the real property owned by corporation, would not trigger right of first refusal); *Rucker Properties, L.L.C. v. Friday*, 204 P.3d 671, 674-75 (Kan. App. 2009) (holding that gifting of interests in subject property by other owners of the property to lessor by quitclaim deeds did not trigger lessee's right of first refusal, where right was only applicable if "the Lessors desire to sell the property," transfers were made in exchange for one dollar, and no third parties were involved in the quitclaim deeds).

The foregoing cases illustrate the desirability of clearly expressing the intentions of the parties with respect to such transfers in the provisions providing for an option or related right with respect to the property.

III. Carveouts for Transfers of LLC Interests

With respect to transfers of individual interests to LLCs, *see Evans v. S.C. Southfield 12 Associates*, *LLC,* 298 Fed. Appx. 403 (C.A.6 (Mich.), 2006). In this case, the court noted that "Michigan courts have held that a contract provision containing a right of first refusal must be interpreted narrowly." *Id*. at 407. The court ruled that the property owners' intention to transfer their interest in commercial property to their LLC, of which they were the sole owners, and where the membership interests were in the same proportion as their existing

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ownership interests, for no monetary consideration, did not constitute a "desire to sell" in connection with "a bona fide written offer" to purchase the property and did not trigger the tenant's first right of refusal under the lease. The court reasoned that such a right would only apply if the landlord, as the property owners' successor-in-interest, desired to sell the property and received a bona-fide written offer to purchase it. The court found that in this case the transfer was not supported by valuable consideration, there was no written offer of purchase from the LLC, and the motive for transfer was not to deprive the tenant of its right of first refusal. The court further ruled that even if the transfer to the LLC constituted a "bona fide written offer," the transfer was contractually exempt from the right of first refusal because the lease stated that it did not apply in the event of the landlord's sale or transfer to any of its officers, directors, and principal shareholders, or to any corporations and/or other entities in which the landlord had any substantial interest. The court stated: "It is beyond dispute that the proposed transfer of interest from the Evans to [the new LLC] was not the result of arms-length dealing and would not result in any real change in control of the property." *Id.* at 408. The court cited several cases from other jurisdictions (Michigan never having specifically addressed the issue) holding "that the transfer of interest from individual owners to another entity controlled by those same individuals does not constitute a 'sale' that triggers a right of first refusal." *Id.* at 407. The *Evans* case clearly highlights the importance of clear and concise drafting of the first right of refusal, as the plaintiff in that case (the tenant) claimed that it should be able to purchase the real property for nothing! (Thereby matching the "consideration" paid by the existing owners for transferring the property to the LLC.)

But see Gebhardt Family Restaurant, L.L.C. v. Nation's Title Ins. Co. of New York, 132 Md. App. 457 (2000). In this case, the court held that a transfer of land from two family members to an LLC, of which they were the only members, terminated coverage under a title insurance policy naming the individual family members as the insured parties. The Gebhardts argued that they nonetheless remained insured parties under the title policy because the conveyance was, in effect, to themselves, and therefore they still retained an "interest" in the property. However, the appellate court ruled that "[i]n contrast to a partnership, a limited liability company in Virginia is an entity separate from its members and, thus, *the transfer of property from a member to the limited liability company is more than a change in the form of ownership; it is a transfer from one entity or person to another* (emphasis in text) (citation omitted)." *Id.* at 463. The court held that while the Gebhardts had an interest in the LLC (which was a personal property interest), they no longer had an interest in the real property as the result of their conveyance of the property to the LLC. The court also rejected the Gebhardts' claim that there was no "real" conveyance because the LLC in fact paid no consideration, ruling that the conveyance to the LLC provided the Gebhardts with actual and substantial benefits, including limited liability and estate planning benefits.

IV. Carveouts for Deeds in Lieu of Foreclosure

With respect to deeds in lieu of foreclosure, *see Pelladini v. Valadao*, 113 Cal. App. 4^{th} 1315, 1317 (2003). In this case, the court ruled that the holder of a right of first refusal on real property, which was owned by two sisters as tenants in common, was not triggered when one of the sisters gave the other a deed in lieu

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of foreclosure of her undivided one-half interest in the property as satisfaction of a note and deed of trust on her interest in the property obtained from the other sister. The court held that the agreement containing the right of first refusal referred to the tenants in common in the conjunctive and the property was referred to in the singular with no mention of the property other than as a whole, therefore indicating that the phrase "bona fide offer for purchase" was intended to be triggered by the sale of the cotenants' combined interest to a third party. The court found that "[t]here was no sale to a third party in this case." *Id.* at 1322.

V. Carveouts for Transfers of Partnership Interests to Individuals

With respect to transfers of partnership interests to individuals, the courts have generally held that they are outside the scope of an option or first-right of refusal provision. For example, in *Hartzheim v. Valley Land & Cattle Co.*, 153 Cal. App. 4th 383 (2007), the court held that the lessor, which was a family-owned partnership, did not trigger the lessee's right of first refusal on the sale of the real property, as contained in lease, when it transferred the property to the partners' grandchildren, because it was not made pursuant to a bona-fide offer for the purchase of the property from a third party (the grandchildren were contingent beneficiaries under the partnership agreement) in an arms-length transaction, and was made for legitimate income-tax and estate-planning purposes. The court stated that "it is the occurrence of both an arms' length transaction and change in control of the property that characterizes a bona fide sale." *Id*. at 393.

See also Bill Signs Trucking, LLC v. Signs Family Ltd. Partnership, 157 Cal. App. 4th 1515 (4 Dist. 2007) (appellate court affirmed trial court's ruling that commercial lease's "preemptive purchase right" provision allowing tenant right of first refusal if landlord received acceptable offer from "any person" referred only to third persons; court held that provision was not triggered by transfer between partners in family limited partnership that owned property and that parol evidence showed original owner's strong interest in keeping property in family; court further determined that transfer between partners had no effect on tenant's rights under lease or its preemptive rights against third-party purchasers).

VI. Carveouts for Portfolio or Bulk Sales

With respect to portfolio or bulk sales, the majority of courts hold that where an owner sells or attempts to sell property burdened by a right of first refusal as part of a larger package of properties, the right of first refusal is not defeated, but is also not activated in its traditional sense.

For example, in *First Nat'l Exchange Bank of Roanoke v. Roanoke Oil Co.*, 169 Va. 99, 113 (1937), the court stated, at 113:

> The record discloses that the manifest intention and import of clause eight of the lease [the right-of-first-refusal clause] was inserted for the protection of the lessee and its investment in the filling station. A sale of the property occupied by the oil company, free of the lease thereon, separately, or with other property, would seem in either event, under the language of the lease, to constitute "a sale of the said premises." It is clear that if the leased premises could be sold together with other property, discharged of the lease,

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> without an opportunity being given to the lessee to purchase the whole property sold, or, at least, that portion occupied by it, the intention and purpose of the option would be completely destroyed. Certainly, any sale of the leased premises, free of the lease, affected both the premises and the lease.

See also Wilber Lime Products, Inc. v. Ahrndt, 268 Wis.2d 650, 656 (Wis. App. 2003) ("we agree with the circuit court's decision that the sale of the entire 180-acre farm to [a third party] triggered [the holder of the] right of first refusal to the twenty-five acres. Granting specific performance protects [the holder's] right of first refusal. [The holder] expected to be offered the opportunity to purchase the twenty-five acres in the event they were ever sold. The twenty-five acres were sold, albeit as part of a package deal. [The holder] should therefore have had the right to purchase the land); *Boyd & Mahoney v. Chevron, USA*, 419 Pa. Super. 24, 29-30 (1992) ("[A] right of first refusal as to the conveyance of a property cannot be defeated by including that property in a multi-property or multi-asset transaction . . . The appellant's argument that the right can be nullified simply by packaging the property for sale with another asset not so encumbered has no merit. Appellants' logic would deprive the holder of the right the benefit of his or her bargain"); *Stuart v. Stammen*, 590 N.W.2d 224, 228 (1999) (ruling that holder of right of first refusal could not be forced to purchase property in addition to that which was subject to such right); *Landa v. Century 21 Simmons & Co., Inc.*, 237 Va. 374 (1989) (holding that holder of right of first refusal cannot be compelled to purchase more than is subject to right of first refusal or else forfeit first-refusal right); *Raymond v. Steen*, 882 P.2d 852, 857 (Sup. Ct. Wyo. 1994) ("a right of first refusal is not triggered by an offer on a larger tract which includes the burdened property. Neither is a right of first refusal satisfied by an offer to the holder of the right to sell him a larger tract"); *Gyurkey v. Babler*, 103 Idaho 663, 668 (1982) (holding that even though vendor separately valued, as a part of total transaction, lot as to which plaintiff had right of first refusal, such lot could not be sold as part of larger parcel as long as lot was subject to such right of first refusal, because "the door would be opened to a myriad of unscrupulous endeavors designed to defeat preemptive rights of purchase by manipulation of lot prices within the terms of a larger sale"); *Whyhopen v. Via*, 404 So.2d 851, 853 (Fla. Dist. Ct. App. 1981) (landlord could not refuse to honor tenants' first refusal right on theory that tenants had not agreed to purchase entire parcel described in contract for sale); *Thomas & Son Transfer Line, Inc. v. Kenyon, Inc.*, 40 Colo. App. 150, 155 (1977), *aff'd* 586 P.2d 39 (Colo. 1978) (holding that owner of property cannot defeat right of refusal simply by selling optioned property with other properties that he may own; and stating that "To deny specific performance here would be to defeat the entire purpose of the right of refusal, the protection of the lessee"); *Guaclides v. Kruse*, 67 N.J. Super. 348, 359 (1961) ("We concur in the generally accepted view as to the optionee's right to an injunction to restrain a vitiating of its option by the inclusion, in the owner's prospective sale, of property in excess of that covered by the option. To allow the owner of the whole to by-pass the optionee merely by attaching additional land to the part under option would render nugatory a substantial right which the optionee had bargained for and obtained"); *Brito v. Belvedere Developers, LLC*, 2004 WL 877565 (R.I. Super., March 29, 2004) (unpublished opinion) ("Owners should not be permitted to attempt to sell their encumbered parcels to third parties by joining with

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other landowners, and then be able to deny the rightholder an opportunity to exercise his right by arguing that the encumbered parcel was part of a larger package"); *Sawyer v. Firestone*, 513 A.2d 36, 40 (R.I. 1986) ("a seller may not defeat a right of first refusal by selling the property subject to the right as part of a larger tract"); *Aden v. Estate of Hathaway*, 162 Colo. 311, 314 (1967) (ruling that holder of right of first refusal is entitled to injunctive relief, enjoining sale of burdened parcel, when owner decides to sell encumbered parcel as part of larger tract); *Chapman v. Mut. Life Ins. Co. of New York*, 800 P.2d 1147, 1151-52 (Wyo. 1990) (holding that while package deal did not trigger right of first refusal in its traditional sense, such that rightholder could purchase the property, rightholder was entitled to injunctive relief with respect to sale of burdened property; court stated that most often, courts will "return to the *status quo ante* and require a bona fide offer on the smaller tract before the right may be exercised or considered waived"); *USA Cable v. World Wrestling Fed'n Entertainment, Inc.*, 2000 Del. Ch. LEXIS 87 (Del. Ch., June 27, 2000), *aff'd* 766 A.2d 462 (Del. Super. 2000), at *44 ("New York courts construing right of first refusal clauses have uniformly held that a property owner cannot compel the holder of a right of first refusal to one property to match the terms of a package deal encompassing extraneous properties"); *New Atlantic Garden v. Atlantic Garden Realty Corp.*, N.Y. App. Div., 194 N.Y.S. 334 (1st Dep't 1922), *aff'd* 237 N.Y. 540 (1923) (holding that lessee of movie theater with right of first refusal cannot be forced to match terms of third party's offer to buy from lessor a larger parcel including the theater); *Myers v. Lovetinsky*, 189 N.W.2d 571, 575 (Iowa 1971) ("This is a case in which landlords sell the whole farm including the demised premises to purchasers without separately pricing the demised premises and the rest of the farm. The decisions recognize in this kind of case, apparently without exception, that the landlord breaches the tenant's preferential right [of first refusal] by so doing"); *Ollie v. Rainbolt*, 1983 OK 79, 669 P.2d 275, 280 (1983) ("Because the owner breached the tenant's preferential right by attempting to sell the leased premises as part of the larger tract, the tenant can seek injunctive relief to maintain the status quo until the end of the lease term, when his preferential right will have expired"); *Radio Webs, Inc. v. Tele-Media Corp.,* 249 Ga. 598, 601-02 (1982) (applying rule of law from lease cases holding that sale of parcel larger than the property for which a lessee held a right of first refusal was a breach of contract, and finding that rule applied to sale of a business; court ordered trial court to enter temporary injunction in favor of radio company and take whatever steps were necessary to protect its potential right to relief); *Maron v. Howard*, 258 Cal. App. 2d 473, 486-87 (1968) (holding that landlord cannot prevent exercise of right of first refusal to purchase property by accepting offer to purchase larger parcel including parcel subject to right); *Wilson v. Brown*, 5 Cal. 2d 425, 430 (Ca. 1936) (holding that where lessors conveyed mortgaged land, which included premises leased with option to purchase, trial court correctly ordered purchasers to convey leased premises to lessees free of encumbrances, with provision for retaining jurisdiction in case of default by purchasers); *Tarallo v. Norstar Bank*, 534 N.Y.S.2d 485, 487 (N.Y. App. Div. 1988) (lessees could not compel conveyance of entire parcel, as right of first refusal did not extend to entire parcel). *Cf. Rottier v. Walsh*, 230 Wis.2d 748 (1999) (unpublished opinion) at *3 (holding that unambiguous language of right of first refusal did not permit respondent to require rightholder to either purchase a portion of the parcel or abandon her right of first refusal on that portion, and remanded with instructions to issue declaratory relief and

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injunction; court stated that "The only reasonable meaning attributable to the document is that Walsh and Rottier intended the ROFR to apply to a sale of the entire property").

A minority of courts holds that the holder of the right of first refusal is entitled to specific performance on the burdened property alone (as opposed to injunctive relief), and that if the rightholder chooses not to exercise the right then the owner can proceed with the sale of the larger package. These courts generally have granted relief in the form of specific performance at a value set by the court or monetary damages, or where the parties have themselves assigned values to the different properties included in the package. *See, e.g., Berry-Iverson Co. of N.D., Inc. v. Johnson,* 242 N.W.2d 126, 134 (N.D. 1976) (holding that attempted package sale activates right of first refusal, entitling rightholder to specific performance on burdened property alone); *Brenner v. Duncan*, 318 Mich. 1, 6 (1947) (ruling that with respect to attempted package sale including burdened property, "it is competent for the court to fix the option price, afford the optionee an opportunity to accept and thereupon specifically enforce the resulting contract"). In *Pantry Pride Enter., Inc. v. Stop & Shop Cos., Inc.,* 806 F.2d 1227, 1231-32 (C.A.4 (Va.),1986)., the court concluded that specific performance was the more appropriate remedy where the parties to the sale assigned separate valuations to the personalty and leasehold interests and, therefore, the problems commonly associated with awarding specific performance in such cases were not present. The court stated:

> In the typical case, a landowner leases a portion of his property to a lessee, who secures a right of first refusal. The landowner subsequently agrees to sell the leased portion and some adjacent property to a third party for a single price. When the lessee tries to purchase only the leased portion of the package, the lessor tries to force the lessee into accepting the package deal or allowing the sale. Most courts resolve this conflict by enjoining the sale of any property subject to the lessee's option. [Citations omitted.] Several practical problems arise in granting specific performance in these contiguous property cases. The first problem is one of valuation. If a court allows the lessee to buy only the leasehold portion, the court must allocate the single purchase price between the leased portion and the remainder of the lessor's property. Some courts are reluctant to undertake this process, which may require the court to determine the value of each acre offered for sale. [Citations omitted.] The second problem is that specific performance may be inequitable for three reasons. First, if the lessor sold the leased and nonleased portions together, he would probably receive a greater price than if he sold the properties separately. By forcing the lessor to sell only the leased portion, the court may be depriving the lessor of this premium. Second, the remaining property may be difficult to sell without the attached leased portion. Third, specific performance forces the lessor to separate his contigu-

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> ous property merely because he leased a portion of it to the lessee. Because of these equitable considerations, most courts do not grant specific performance, but simply protect the lessee's option by enjoining the sale of the leased portion.
>
> *Id.* at 1229-30.

Only one case appears to take the position that the rightholder's failure to enter into an agreement addressing the possibility of a package deal leaves the rightholder without a remedy. *See Cross-Spieker #23 v. Robert L. Helms Const. & Devel. Co.*, 731 P.2d 348, 350 (Nev. 1987) ("It is apparent from the terms of the right of first refusal, that the right applied only to offers to purchase Tract B. In this case, there was no such offer. Of course, we would not condone an attempt to evade [the holder of the right of first refusal's] contractual rights by engineering the sale of a larger parcel (citations omitted), but in this case there was no evidence of any wrongful intent. Rather, the record reflects a good faith decision by [the optionor] to sell the entire tract. Thus, [the holder of the right of first refusal's] contractual right was totally inapplicable by its own terms").

If the language in the first-right-of-refusal clause is vague as to the terms and conditions under which the right may be exercised (including the amount of property covered), or specifically covers more than one parcel, the rightholder may be forced to match an offer for the entire package or else lose its right of first refusal. *See, e.g., West Texas Transmission, L.P. v. Enron Corp.,* 907 F.2d 1554, 1564 (5th Cir. 1990) ("most courts have insisted that [holders of rights of first refusal] replicate a myriad of nonprice conditions, including . . . the purchase of a larger quantity of land"); *In re New Era Resorts*, LLC, 238 B.R. 381, 387 (Bankr. E.D. Tenn. 1999) (stating that "The parties did not define the word 'terms' in . . . the Lease Agreement to require the debtor to market the restaurant tract alone"; and ruling that because holder of right of first refusal rejected offer to purchase restaurant parcel together with other property and offered only to purchase restaurant parcel, right of first refusal lapsed and rightholder's offer constituted rejection and counter-offer, which debtor was free to and did reject). *But see* USA Cable v. World Wrestling Fed'n Entertainment, Inc., supra, 2000 Del. Ch. LEXIS 87, at *49 (distinguishing *West Texas Transmission, supra,* and stating that "*In re New Era Resorts [supra]* does not represent New York law on this subject").

Courts generally will strictly construe rights of first refusal and resolve ambiguities in favor of the grantor of the right, whether in connection with package sales or other issues concerning rights of first refusal. *See*, *e.g., Crestview Builders, Inc. v. The Noggle Family Ltd. P'ship*, 352 Ill. App. 3d 1182, 1187-88 (2004) (holding that right of first refusal was not enforceable due to vagueness where it did not contain a price term and did not specifically state that price would be set by competing offer); *Creque v. Texaco Antilles Ltd.*, 409 F.3d 150, 155, (C.A.3 (Virgin Islands), 2005) (holding that transfer of assets and liabilities by owner of property in connection with corporate restructuring, where conveyance was between two subsidiary corporations each owned by same parent, was not equivalent of "bona fide offer to purchase" sufficient to trigger right of first refusal with respect to real property). *Cf. Uno Restaurants, Inc. v. Boston Kenmore Realty Corp.*, 441 Mass. 376, 387-89 (2004) (holding that bona fide offer to landlord existed where landlord received legitimate non-collusive offer to purchase property from third party, even if that offer was higher than

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market value; landlord did not violate covenant of good faith and fair dealing where lease did not require any particular action by landlord to protect tenant's right of first refusal); *J & J Telecom v. AT&T Wireless Services, Inc.*, 2005 WL 1126924 (W.D. Wash., May 10, 2005), at *8-9 (upholding plaintiff's right of first refusal and stating that "nothing in any of the partnership agreements limited to whom the partnership assets could be sold. If the parties intended to limit the sale to non-affiliated entities, they could have done so in the agreements. The language regarding sales is unambiguous"; court distinguished *Creque v. Texaco Antilles Ltd.*, *supra*, based on facts of that case, including fact that no money was exchanged).

At least one court held that with respect to a package deal including the encumbered property, if the holder of the right of first refusal elected to exercise the right the rightholder was entitled to preemptive specific performance on the entire package. *See Capalongo v. Giles*, 425 N.Y.S.2d 225, 228 (N.Y. Spec. Term 1980) ("where an owner does have an offer from a third party to purchase a piece on which he has given a first refusal option, but on terms which specify inclusion of the piece in a larger parcel . . . he thereupon has a duty to offer the whole parcel to the option holder on the same terms"). But this decision was reversed on appeal, *sub nom Capalongo v. Desch*, 81 A.D.2d 689, 690 (N.Y. App. Div. 1981), *appeal dismissed*, 54 N.Y.2d 680 (1981), *aff'd*, 57 N.Y.2d 972 (1982), on the narrow issue of the adequacy of the consideration for the right of first refusal. The appellate court found that failure to give adequate consideration made the option agreement revocable. The owners of the property also contended that the option was in fact revoked by the rightholders, because the owners had advised the rightholders that they would not sell the triangular parcel (which was subject to the right of first refusal) separately from the remaining 123 acres. According to the owners, the rightholders stated that they were not interested in purchasing the larger tract. The owners also claimed that execution of the third-party contract for the entire 123 acres constituted a revocation of the option since such action was patently inconsistent with the terms of the option. The court agreed, finding that the option, which failed to recite either its duration or that it was irrevocable, was effectively revoked by the subsequent actions of the owners, and that the trial court erred in concluding that the option required the owners to give the rightholders a right of first refusal on the entire 123-acre tract. *See also Qualtronics Mfg. v. Levinson & Jaffe*, 1995 U.S. App. LEXIS 8529, at *3-4 (9th Cir., April 10, 1995) (affirming judgment in favor of lessee that it had not filed a groundless *lis pendens* notice against lessor's property where lease was silent as to whether right of first refusal extended to allow lessee to match an offer for entire business park; court found that district court properly concluded that tenant had "some basis" for its contention, and a "rational argument for its interpretation," that its right of first refusal extended to an offer to purchase other buildings along with its leasehold and, thus, lessee had some basis to record its *lis pendens* on the other buildings).

For an interesting decision on the issue of whether a proposed sale of property to a third party that consists of more than the property that is subject to a right of first refusal obligates the property owner to accept an offer from the holder of the right to purchase only the specific property, *see Thompson v. Herold*, 2004 Cal. App. Unpub. LEXIS 5888 (2d Appellate Div. June 22, 2004), reh'g denied, 2004 Cal. App. LEXIS 1200 (July 14, 2004). In this case a dentist leased the first floor of a two-story building. The lease gave the tenant the right to buy the building for its appraised

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value ($590,000) if the landlord chose to sell the "leased premises." If the tenant did not exercise the right, the lease would remain in effect and the landlord subsequently could offer it for sale to a third party, but the tenant would have a right of first refusal, to be exercised by giving written notice of acceptance within 45 days.

The landlord subsequently offered the building and the adjacent building it owned to the tenant for a net price of $1,165,000. The tenant counteroffered, proposing to purchase only the building he occupied for $590,000, and imposing additional conditions. This counteroffer was not accepted by the landlord by the date set forth in the counteroffer, and the landlord proceeded to place both properties on the market the day after the tenant's counteroffer expired. The landlord then accepted an offer of $1,135,000 for both buildings from a third party (although, "to obtain favorable financing," the third party issued a separate written offer for each property with $790,000 allocated to the building occupied by the tenant and $525,000 for the adjacent building). The landlord then offered the tenant the opportunity to match the $790,000 offer for the building occupied by the tenant. But the tenant insisted that it be allowed to purchase the building for $590,000.

The California appellate court ruled that the tenant's right to purchase the building it occupied for its appraised value was never triggered, so the owner was not obligated to accept the $590,000 offer from the tenant. The court reasoned that to trigger the tenant's right, the owner had to offer to sell the tenant only the building occupied by the tenant. Because the landlord offered two buildings to the tenant, the court ruled that the tenant's right was never triggered. According to the court, "[the tenant's] right has not yet arisen because [the landlord] listed the buildings as a package, rather than as individual properties. This failed to trigger [the tenant's] preemptive right to purchase a single building, as required under the . . . lease . . . [the landlord] ha[s] failed to present [the tenant] with an offer that specifies the purchase price of [the building occupied by the tenant] as a single building." *Id*. at *13-14.

Interestingly, the court prefaced its holding by engaging in a discussion of the differences between an option and a "preemptive purchase right." With respect to options the court stated that, "At the outset, we must distinguish between an option contract and a preemptive purchase right because the parties use the term interchangeably. The important distinction is that only an option contract may be specifically enforced. A preemptive right is not subject to specific performance because it is not a contract (citation omitted). An irrevocable option is a contract made for consideration, to keep an offer open for a prescribed period (internal quotations and citation omitted). It is a unilateral contract and is binding on both parties (citation omitted). If the seller refuses to perform, the contract may become the subject of a suit for specific performance (citation omitted). The decision to exercise an option rests with the prospective purchaser." *Id*. at *9-10.

With respect to first rights of refusal (or, as the court describes them, "preemptive purchase rights"), the court stated that, "By contrast, a preemptive purchase right is dependent upon the owner's decision to sell his property (citation omitted). A preemptive right gives the grantee the first opportunity to purchase property if the owner chooses to sell (citation omitted) (emphasis in text). If the owner elects not to sell, the buyer cannot com-

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pel a sale (citation omitted). For this reason, a preemptive purchase right is not a contract and may not be specifically enforced (citation omitted)." *Id*. at *10-11.

Attached hereto as **Appendix A** is a sample form of first-right-of-refusal clause for insertion in a lease, with numerous "carveouts" for items not intended to be granted to the holder of the right. *See generally* Sara Church Dinkler and Morgan R. Smock, *Toss That Form Book: How to Draft an Effective Right of First Refusal*, 16 NO. 4 ACCA Docket 50 (July/August 1998), at 59; Harris Ominsky, *Real Estate Options: Using Them and Losing Them (Part 1)*, 15 NO. 6 PRAC. REAL EST. LAW. 55 (November, 1999), at 65; Bernard Daskal, *Rights of First Refusal and the Package Deal*, 22 FORDHAM URB. L.J. 461 (Winter 1995); Thomas J. Goger, *Landlord and tenant: what amounts to "sale" of property for purposes of provision giving tenant right of first refusal if landlord desires to sell*, 70 A.L.R. 3d 203 (originally published in 1976); Jean E. Maess, *Option to purchase real property as affected by optionor's receipt of offer for, or sale of, larger tract which includes the optioned parcel*, 34 A.L.R. 4TH 1217 (Originally published in 1984).

VII. Conclusion

As evidenced by the cases and statutory law discussed in this article, it is imperative for the parties to contractual option rights, rights of first refusal, and related rights to carefully and comprehensively draft the documents describing such rights so that they clearly express the intention of the parties with respect to the scope of the rights granted (especially the types of transfers that are covered and are not covered), in order to avoid unintended and undesirable consequences. As noted in the article, it is especially important to address specifically any desired "carveouts" from coverage -- *e.g.*, condemnation or sale to a governmental entity; portfolio or package sales that include other properties along with the property subject to the option or related right; sales or transfers of equity interests in entities owning the property (including stock transfers and transfers between tenants in common) that would effectively constitute an a sale of the property; foreclosure or deed in lieu of foreclosure; gifts and donations; certain indirect transfers of the properties or the equity interest(s) therein; sales or transfers by individuals to family members or into estate-planning trusts or LLCs or transfers of partnership or LLC interests in family-owned partnerships or LLCs to individual family members; and sales involving exchanges of real estate or exchange of the property or other types of exchanges for non-cash consideration. [Note: in the case of tax-free exchanges under § 1031 of the Internal Revenue Code, or other non-cash consideration (such as unique personal property) for the sale, transfer, or exchange of the property covered by the option or related right, what if nothing is said in the documentation to cover such a situation? From a drafting standpoint, it probably would be wise to either exclude any such transaction from the option or related right altogether, or else provide a valuation mechanism, perhaps enforceable by arbitration if the parties are unable to agree upon the value of the consideration within a specified period of time, whereby the optionee would have the ability to pay the consideration, as so determined, in cash]. Each of these carveouts must be specifically and comprehensively drafted to address the clear intentions of the parties. As this article clearly illustrates, clauses regarding options to purchase and related rights contained in leases and other legal documents are very complex and require a great deal of attention from counsel, with respect to both the business terms and the legal aspects and consequences.

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APPENDIX A

RIGHT OF FIRST REFUSAL (LEASE PROVISION)

a. **Right of First Refusal.** Provided that Tenant:

(i) Is not in default under this Lease,
(ii) Has not assigned this lease or sublet all or part of the Premises, or
(iii) Is not holding over in the Premises,

if Landlord enters into a contract to sell its entire fee interest in the Premises (and only the Premises) (a "Sale"), Tenant shall have a one-time right of first refusal to purchase of the entire Premises ("Refusal Right"). In the event of a Sale, Landlord shall notify Tenant in writing of the prospective Sale of the Premises ("Landlord's Notice"). Landlord's Notice shall include the elements of the business deal of such prospective Sale (the "Elements"), and a contract of sale executed by Landlord containing the material terms of the Sale (the "Contract of Sale") for Tenant's signature.

b. **Tenant's Exercise of Right.** In order to exercise the Refusal Right, Tenant shall:

(i) Accept the terms of the Sale as set out in the Contract of Sale by notifying Landlord, in writing, sent by registered or certified mail, return receipt requested, of its intent to so accept, postmarked within five (5) business days after receipt of Landlord's Notice; and
(ii) Execute and return to Landlord the Contract of Sale within fifteen (15) days after receipt of same from Landlord.

c. **Proof of Financing.** If Tenant shall timely exercise the Refusal Right, Tenant shall, within five (5) days following its execution of the Contract of Sale, provide Landlord with evidence of a non-contingent financing commitment or other evidence acceptable to Landlord, in Landlord's sole and absolute discretion, of Tenant's ability to close on or before the closing date set forth in the Contract of Sale. If Tenant has not shown Landlord such evidence within the five (5) day period, Landlord shall have no obligation to sell the Premises to Tenant and Tenant's rights under this Clause shall forever be null and void.

d. **Closing.** Following Landlord's receipt of satisfactory evidence from Tenant of Tenant's ability to close pursuant to the terms of the Contract of Sale, Landlord and Tenant shall proceed to close the sale of the Premises no later than the closing date set forth in the Contract of Sale.

e. **Lapse of Refusal Right.** If Tenant shall fail to timely perform any of its obligations as set forth herein, or if Tenant shall opt not to exercise the Refusal Right, the Refusal Right shall lapse and Landlord shall be free to sell the Premises pursuant to the Elements or any subsequent agreement for the transfer of the Premises.

f. **No Assignment of Right.** The Refusal Right is personal to Tenant and may not be assigned by Tenant in connection with and assignment of this Lease or otherwise. The

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Refusal Right may not be exercised by anyone other than Tenant. Any attempted assignment of the Refusal Right shall be of no effect and the Refusal Right shall become forever null and void as of the date of the purported assignment.

g. **Events Not Triggering Refusal Right.** *Anything contained herein to the contrary notwithstanding, in the event of any of the following, the Refusal Right shall be deemed not to have arisen and of no force and effect:*

(i) The sale of the Premises to an Affiliate (as defined in Clause _____ hereof) of Landlord or to a government entity;

(ii) The sale of the Premises in connection with a sale of all or substantially all of Landlord's assets or shares (or interests);

(iii) Landlord's shares becoming or continuing to be traded on the New York, or Over-the-Counter stock exchange or market or any similar exchange or market;

(iv) The entering into of any management agreement or any similar agreement which transfers control of the Premises by Landlord;

(v) The entering into by Landlord of any ground lease, mortgage, or trust deed upon all or any portion of the Premises, any advances made thereunder and all renewals, modifications, consolidations, replacements, extensions, and re-financings thereof; or

(vi) The entering into a contract by Landlord for the sale of more than one property wherein the Premises is one of such properties.

(vii) Sale or transfer of the Premises by foreclose, deed in lieu of foreclosure, or bankruptcy sale.

(viii) Any like-kind exchange with respect to the Premises under § 1031 of the Internal Revenue Code, or any other sale or transfer of the Premises for non-cash consideration. [Note: In lieu of the foregoing, a method of valuation for any non-cash consideration could be inserted, perhaps with an arbitration requirement if the parties are unable to agree on the cash value of such consideration within a certain period of time].

(viii) Any gift or donation of the Premises.

h. **Subordination.** The Refusal Right shall be subject and subordinate to any mortgage now or hereafter placed upon the Premises or any portion of the [*Building/Center*], and to any renewals, modifications, consolidations, replacements, extensions, and re-financings thereof. Tenant agrees to execute and deliver whatever instruments may be requested by any Lender for such purposes. If Tenant fails to do so within ten (10) days after demand in writing, Tenant does hereby make, constitute, and irrevocably appoint Landlord as its attorney-in-fact (which shall be deemed to be coupled with an interest) and in its name and place to execute and deliver such instruments. ■

ACRELades

Dennis Arnold received the Outstanding Real Estate Lawyer Award from the LA County Bar Association.

Lynn Axelroth has been honored by the Commercial Real Estate Women (CREW) Philadelphia for her impact on the commercial real estate industry.

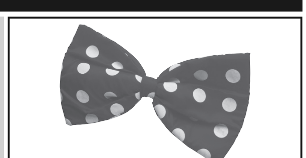
David Callies is the recipient of a University of Hawaii Regents Medal for Excellence in Teaching for the 2008-2009 school year.

William Carr is a 2009 recipient of the Baron of the Boardroom award from the Kansas City Metropolitan Bar Association.

Best Lawyers in America has recognized many ACREL Fellows as Real Estate Lawyers of the Year for 2009, including **Louis Eatman in Los Angeles, Phil Nicely in Indiana, J. Fred Powell in Birmingham,** and **Susan Talley in New Orleans.**

Daniel Klein and Robert Krapf have been named in *The International Who's Who of Real Estate Lawyers 2009* and *Chambers USA – America's Leading Lawyers for Business.*

Newly-elected Fellow **Tom Nealon** raised over $109,000 this year for the American Liver Foundation (ALF), bringing his fundraising for the Biliary Atresia Fund for the Cure to over $425,000 over the past six years! ALF has named one of its 2009 Postdoctoral Research Fellowships for Tom. ■



Featured Website: SNL Real Estate Securities Daily

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SNL provides updates on current real estate market activity on over 600 public real estate companies worldwide. A newsletter subscription will provide users with basic information on each of the companies including a corporate profile, executive compensation, insider activity, EDGAR filings, upcoming events, and company press releases. If you subscribe to the data portion of the service, you can get additional information such as financials, property portfolio, property transactions, top tenants, top markets, investor presentations and transcripts, M&A history, and capital structure. They base their price on the services requested, the number of users, and other criteria. SNL issues a daily on line newsletter around midnight (E.S.T.), and the news service is updated throughout the day. You can sign-up for just the daily news, a twice daily market report, or live updates on companies of interest.

2009 Annual Meeting

J.W. Marriot

Washington, D.C.

October 29 -
November 1, 2009

The Saturday night dinner-dance
will have a Halloween theme!

Register today
...or else!