FIRST-REFUSAL RIGHTS UNDER TEXAS LAW

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I. INTRODUCTION

Among the many ubiquitous provisions in commercial contracts (usually found well toward the back) are rights of first refusal.[1] Because

[1] This contract right also been called, among other things:

(1) A "preferential right of purchase" or, more simply, a "preferential right." *E.g.*, W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1561 (5th Cir. 1990) (applying Texas law). *See, e.g.*, Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 644 (Tex. 1996); Mandell v. Mandell, 214 S.W.3d 682, 686 n.1 (Tex. App.—Houston [14th Dist.] 2007, no pet.) (noting that "a preferential right to purchase provides no greater rights than a right of first refusal").

(2) A "preemptive right to purchase" or, more simply, a "preemptive right." *E.g.*, Turner v. Shirk, 364 N.E.2d 622, 623–24 (Ill. App. Ct. 1977); Barling v. Horn, 296 S.W.2d 94, 97 (Mo. 1956).

(3) A "first option to buy." *E.g.*, Town of Eustis v. Stratton-Eustis Dev. Corp., 516 A.2d 951, 954 (Me. 1986); L.E. Wallach, Inc. v. Toll, 113 A.2d 258, 259 (Pa. 1955).

(4) A "first call." *E.g.*, 11 THOMPSON ON REAL PROPERTY, SECOND THOMAS EDITION § 96.03(b), at 572 (David A. Thomas ed., 2002).

(5) Even erroneously an "option." *E.g.*, Cont'l Cablevision of New England, Inc. v. United Broad. Co., 873 F.2d 717, 722 (4th Cir. 1989) (applying Massachusetts law) ("Initially, it is clear that a right of first refusal is a type of option."); Myers v. Lovetinsky, 189 N.W.2d 571, 576 (Iowa 1971) (noting a "preferential right . . . is a species of option"); David A. Bramble, Inc. v. Thomas, 914 A.2d 136, 143 (Md. 2007) ("A right of first refusal, or 'preemptive right,' is a type of option . . . .").

See also Cipriano v. Glen Cove Lodge No. 1458, B.P.O.E., 801 N.E.2d 388, 390–93 (N.Y. 2003) (describing different terminology applied to first-refusal rights); 3 ERIC MILLS HOLMES, CORBIN ON CONTRACTS § 11.3, at 469 n.1 (rev. ed. 1996) (same) [hereinafter CORBIN]; Bernard Daskal, *Rights of First Refusal and the Package Deal*, 22 FORDHAM URB. L.J. 461, 463–64 (1994) (same). Because the emphasis should be on the word "right," "first-refusal right" is the most apt description and will be used to refer to the right in this Article.

The label applied by the parties to a contractual provision does not always mirror the provision's legal effect. Accordingly, courts and practitioners should review the provision's terms carefully. *See, e.g.*, Briggs v. Sylvestri, 714 A.2d 56, 57 n.3 (Conn. App. Ct. 1998) (recognizing that a contractual provision labeled "option" was a first-refusal right); Berry-Iverson Co. of N.D. v. Johnson, 242 N.W.2d 126, 131 (N.D. 1976) (same); Overton v. Bengel, 139 S.W.3d 754, 757

such provisions often are tangential to a transaction's main purpose, and because the first-refusal right concept seems straightforward—typically, if the right's grantor decides to sell certain property, the right's holder has the right to buy the property on the same terms and conditions set forth in a third party's bona fide offer[2]—practitioners often use a boilerplate first-refusal right from either a form book or a previous contract with little further thought. Consequently, they wholly fail to consider alternative provisions that might meet contracting parties' goals better.

Behind the first-refusal right's seeming straightforwardness, however, lurk questions that repeatedly bedevil Texas courts and practitioners, such as: (1) what triggers the holder's right to exercise the right; (2) what notice must the owner give the holder about a third party's offer and what obligation does the holder have to seek clarification of an incomplete or ambiguous notice; (3) how is the right exercised; and (4) when and under what circumstances does the right terminate?

Long and costly litigation often results when a first-refusal right fails to answer these questions clearly. This Article's purpose not only is to answer them when the first-refusal right fails to do so, but also to provide a

(Tex. App.—Texarkana 2004, no pet.) (recognizing that a contractual provision labeled "right of first refusal" was an option); John D. Stump & Assocs., Inc. v. Cunningham Mem'l Park, Inc., 419 S.E.2d 699, 703 (W. Va. 1992) (recognizing that a contractual provision labeled "option" was a first-refusal right); CORBIN, *supra*, § 11.4, at 488 ("Whether a party has a right of first refusal is an issue of interpretation.").

[2] *E.g.*, *W. Tex. Transmission*, 907 F.2d at 1561 ("A 'right of first refusal' . . . permits the rightholder to purchase the subject property, once the owner chooses to sell, on the terms and conditions specified in the contract granting the right."); *Tenneco*, 925 S.W.2d at 644 ("A right of first refusal . . . empowers its holder with a preferential right to purchase the subject property on the same terms offered by or to a bona fide purchaser."); Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 532 (Tex. App.—Waco 2008, pet. denied) ("Generally, a preferential right [of first refusal] requires the owner of the subject property to offer the property first to the holder on the same terms and conditions offered by a third party."); Nat'l Adver. Co. v. Potter, No. 01-06-01042-CV, 2008 WL 920338, at *3 (Tex. App.—Houston [1st Dist.] Apr. 3, 2008, no pet.) ("A right of first refusal has a generally well established meaning in the business world as giving the holder of such a right the first opportunity to purchase property from the owner on the same terms offered by any third party."); Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 524 (Tex. App.—Amarillo 1998, pet. denied) (same); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. f (2000) ("Rights of first refusal are used to give the seller and others the right to purchase the property when the buyer decides to sell."); CORBIN, *supra* note 1, § 11.3, at 468–69 (noting that first-refusal rights "create a right, a contractual right, to 'preempt' another"); BLACK'S LAW DICTIONARY 1439 (9th ed. 2009) (defining a first-refusal right as "[a] potential buyer's contractual right to meet the terms of a third party's higher offer").

comprehensive guide regarding first-refusal rights under Texas law. Part II describes the first-refusal right in general, distinguishing it from an option and explaining why such provisions are included in contracts. Parts III through VI, respectively, address the questions identified in the preceding paragraph. Part VII discusses the remedies available to a holder of a first-refusal right when the right is breached. Part VIII discusses the affirmative defenses available to a right's grantor and a third party when the holder sues the grantor or the third party in connection with the right's alleged breach. Part IX provides recommendations to practitioners in drafting and exercising first-refusal rights. Finally, Part X discusses alternative provisions that might better meet contracting parties' goals.

II. THE FIRST-REFUSAL RIGHT IN GENERAL

A. The Typical First-Refusal Right

A first-refusal right affects three parties: (1) the grantor (usually a property owner); (2) the holder; and (3) a third party (usually a potential purchaser of the property burdened by the right).[3] In its simplest form, a first-refusal right gives the holder the right to preempt a contract's execution (or consummation) on the terms provided in the right, which typically require the holder to match, within a specified time period, the price and other terms and conditions contained in a third party's bona fide offer.[4]

The following example illustrates an ordinary first-refusal right's operation. Assume that the owner of two contiguous tracts of land, Blackacre and Whiteacre, sells Whiteacre and grants the buyer a first-refusal right on Blackacre. So long as the grantor is unwilling to sell Blackacre, the holder cannot compel the grantor to do so.[5] However, once

[3] Hereinafter, the three parties will be referred to as the "grantor," the "holder," and the "third party." Most first-refusal rights relate to real property interests. *See* sources cited *infra* note 16. Consequently, this Article, in discussing such rights, generally assumes that they relate to such interests and deals with issues relevant to rights relating to real property interests, such as covenants running with the land and the rules against perpetuities and against unreasonable restraints on alienation. Nonetheless, this Article's analyses generally are applicable irrespective of the type of interest burdened by the right.

[4] *See* sources cited *supra* note 2.

[5] *E.g.*, *W. Tex. Transmission*, 907 F.2d at 1562 ("The holder of the first-refusal right cannot compel a recalcitrant owner to convey the property."); Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 589 (Tex. App.—El Paso 2005, pet. denied) ("Until the

the grantor is prepared to accept a bona fide offer from a third party for Blackacre, the grantor must give the holder an opportunity to preempt the sale by notifying the holder of the sale's proposed terms and conditions.[6]

The grantor's notification creates an option in favor of the holder for Blackacre's purchase at the price and on the other terms and conditions of the third party's bona fide offer.[7] When the holder gives notice of its intent to accept the offer and exercise its option, a contract is created between the holder and the grantor.[8]

[first-refusal] right is triggered, its holder may not compel the property owner to sell."); Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 187 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.) ("An owner does not have to sell and, until the owner decides to sell, there is nothing to exercise . . . .").

[6] *E.g.*, *W. Tex. Transmission*, 907 F.2d at 1562 (holding that a first-refusal right "guarantees that the rightholder will receive notice when the owner intends to sell the property, information about the terms and conditions of that sale, and a reasonable period within which to accept or reject the offer"); Prince v. Elm Inv. Co., 649 P.2d 820, 826 (Utah 1982) (stating that a grantor desiring to sell property burdened by right of first refusal "must . . . give [the holder] notice of the third party's offer and his intention to accept that offer"); Raymond v. Steen, 882 P.2d 852, 854 n.3 (Wyo. 1994) ("The grantor must give some notice to the [holder] of his intention to sell and the terms of the offer." (quoting Thomas J. Goger, Annotation, *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. 203, 206 (1976))); CORBIN, *supra* note 1, § 11.3, at 471 ("The owner must notify the holder of the owner's receipt of the third-party offer and the decision to accept it." (citation omitted)).

[7] Durrett Dev., Inc. v. Gulf Coast Concrete, L.L.C., No. 14-07-01062-CV, 2009 Tex. App. LEXIS 6787, at *10 (Tex. App.—Houston [14th Dist.] Aug. 27, 2009, no. pet. h.) ("A right of first refusal may ripen into an option contract upon the occurrence of a triggering event, as specified in the parties' agreement."); FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., 301 S.W.3d 787, 793 (Tex. App.—Fort Worth 2009, pet. filed) ("[W]hen the property owner gives notice of his intent to sell, the preferential right matures or 'ripens' into an enforceable option."); Collins v. Collins, No. 13-07-240-CV, 2009 WL 620470, at *1 (Tex. App.—Corpus Christi Mar. 12, 2009, pet. denied) ("When the property owner gives notice of his intention to sell, the right of first refusal matures or 'ripens' into to [sic] an enforceable option. The terms of the option are formed by the provisions granting the preferential right to purchase and the terms and conditions of the third party offer . . . ."); *Navasota Res.*, 249 S.W.3d at 533 (same); Comeaux v. Suderman, 93 S.W.3d 215, 220 (Tex. App.—Houston [14th Dist.] 2002, no pet.) ("A right of first refusal ripens into an option when the owner elects to sell.").

[8] *Durrett Dev.*, 2009 Tex. App. LEXIS 6787, at *12 ("[B]efore the option created by the right of first refusal [can] ripen into an enforceable contract, [the holder has] to manifest unambiguous acceptance of the option strictly in accordance with the terms of the agreement."); *FWT*, 301 S.W.3d at 794 ("When the rightholder gives notice of his acceptance of the offer, a contract between the rightholder and the property owner is created."); *Navasota Res.*, 249 S.W.3d at 533 ("When the rightholder gives notice of his intent to accept the offer and exercise his option, a

B. Diversity in First-Refusal Rights

The parties' rights and obligations under a first-refusal right depend on the right's wording. As first-refusal rights' terms vary widely, courts and practitioners must scrutinize their language carefully to ascertain their scope.[9] Moreover, the applications and variations of such rights are almost infinite. For example, even though most first-refusal rights are used to grant a preemptive right to purchase,[10] a first-refusal right also may be used to grant a preemptive right to sell,[11] a preemptive right to lease,[12] a preemptive right to provide services,[13] a preemptive right to be employed,[14] or a preemptive right to employ.[15]

binding contract is created between the rightholder and the property owner."); City of Brownsville v. Golden Spread Elec. Coop., Inc., 192 S.W.3d 876, 880 (Tex. App.—Dallas 2006, pet. denied) (same); Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 525 (Tex. App.—Amarillo 1998, pet. denied) ("[W]hen the rightholder gives notice of . . . acceptance of the offer, a sale contract is created, even if it is stipulated in the agreement that a subsequent formal contract be executed.").

[9] *W. Tex. Transmission*, 907 F.2d at 1562; *see* Glick v. Chocorua Forestlands L.P., 949 A.2d 693, 699–700 (N.H. 2008) ("In all cases, interpretation [of a first-refusal right] requires knowledge of the entire context, context of facts as well as context of words."); St. George's Dragons, L.P. v. Newport Real Estate Group, L.L.C., 971 A.2d 1087, 1098 (N.J. Super. Ct. App. Div. 2009).

[10] *E.g.*, CORBIN, *supra* note 1, § 11.3, at 469; Daskal, *supra* note 1, at 461.

[11] *See, e.g.*, Hyperbaric Oxygen Therapy Sys., Inc. v. St. Joseph Med. Ctr. of Fort Wayne, Inc., 683 N.E.2d 243, 245 (Ind. Ct. App. 1997) (involving a first-refusal right to sell medical equipment).

[12] *See, e.g.*, Ellwest Stereo Theaters, Inc. v. Davilla, 436 So. 2d 1285, 1286 n.1 (La. Ct. App. 1983) (involving a first-refusal right to lease commercial property); Nat'l Adver. Co. v. Potter, No. 01-06-01042-CV, 2008 WL 920338, at *3 (Tex. App.—Houston [1st Dist.] Apr. 3, 2008, no pet.) (involving a first-refusal right to renew a ground lease for billboards); Shell v. Austin Rehearsal Complex, Inc., No. 03-97-00411-CV, 1998 WL 476728, at *1 n.1 (Tex. App.—Austin Aug. 13 1998, no pet.) (involving a first-refusal right to lease additional space in a building).

[13] *See, e.g.*, Simulnet E. Assocs. v. Ramada Hotel Operating Co., No. 95-16339, 1997 U.S. App. LEXIS 19952, at *7 n.1 (9th Cir. 1997) (unpublished table decision) (involving a first-refusal right for satellite television services); Burzynski v. Travers, 636 F. Supp. 109, 111 (E.D.N.Y. 1986) (involving a television director's first-refusal right to direct a film).

[14] *See, e.g.*, Russell v. District of Columbia, 747 F. Supp. 72, 79 (D.D.C. 1990) (involving a hospital employee's first-refusal right on other District of Columbia jobs), *aff'd*, 984 F.2d 1225 (D.C. Cir. 1993).

[15] *See, e.g.*, ABC v. Wolf, 430 N.Y.S.2d 275, 277 (App. Div. 1980) (involving a television station's first-refusal right to a sportscaster's services), *aff'd*, 420 N.E.2d 363 (N.Y. 1981).

Most first-refusal rights occur in real property transactions,[16] such as leases,[17] real-estate sales contracts and deeds,[18] and oil and gas instruments.[19] However, a first-refusal right's subject matter can be

[16] *E.g.*, Miller v. LeSea Broad., Inc., 87 F.3d 224, 226 (7th Cir. 1996) (applying Wisconsin law) ("[I]t is in the real-estate market that rights of first refusal are chiefly found . . . ."); *Burzynski*, 636 F. Supp. at 112 (pointing out that first-refusal rights frequently appear in contracts, "particularly those pertaining to real estate"); *Hyperbaric Oxygen Therapy Sys.*, 683 N.E.2d at 248 ("The right of first refusal is typically associated with the purchase of property, where the holder has the right to purchase the property on the same terms that the seller is willing to accept from a third party."); Unlimited Equip. Lines, Inc. v. Graphic Arts Ctr., Inc., 889 S.W.2d 926, 932 (Mo. Ct. App. 1994) ("Although a first right of refusal is most frequently given in connection with the sale or lease of real estate, it can be given with respect to any matter which is subject to contract." (citations omitted)); CORBIN, *supra* note 1, § 11.3, at 469 (noting that first-refusal rights "customarily, but not exclusively, arise in real property transactions"); Daskal, *supra* note 1, at 461 n.4 ("A majority of cases addressing contracts containing a right of first refusal concern real property.").

[17] *See, e.g.*, A.G.E., Inc. v. Buford, 105 S.W.3d 667, 670 (Tex. App.—Austin 2003, pet. denied); 6500 Cedar Springs, L.P. v. Collector Antique, Inc., No. 05-98-00386, 2000 WL 1176586, at *1 (Tex. App.—Dallas Aug. 21, 2000, no pet.); Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 522 (Tex. App.—Amarillo 1998, pet. denied); Riley v. Campeau Homes, Inc., 808 S.W.2d 184, 186 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.); Holland v. Fleming, 728 S.W.2d 820, 821 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.); Dunlap-Swain Tire Co. v. Simons, 450 S.W.2d 378, 379 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.); Mecom v. Gallagher, 213 S.W.2d 304, 304 (Tex. Civ. App.—El Paso 1947, no writ); Stone v. Tigner, 165 S.W.2d 124, 125 (Tex. Civ. App.—Galveston 1942, writ ref'd).

[18] *See, e.g.*, Starr v. Wilson, 11 So. 3d 846, 853 (Ala. Civ. App. 2008) (involving a first-refusal right in a sales contract); Tadros v. Middlebury Med. Ctr., Inc., 820 A.2d 230, 235 (Conn. 2003) (involving a first-refusal right in a deed); Cherokee Water Co. v. Forderhause, 641 S.W.2d 522, 523 (Tex. 1982) (same); FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., 301 S.W.3d 787, 790 (Tex. App.—Fort Worth 2009, pet. filed) (involving a first-refusal right in a deed); Sanchez v. Dickinson, 551 S.W.2d 481, 482 (Tex. Civ. App.—San Antonio 1977, no writ) (involving a first-refusal right in a sales contract); Raymond v. Steen, 882 P.2d 852, 853 (Wyo. 1994) (same).

[19] *See, e.g.*, Weber v. Tex. Co., 83 F.2d 807, 807 (5th Cir. 1936) (applying Texas law) (involving a first-refusal right in oil and gas lease); Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 528 (Tex. App.—Waco 2008, pet. denied) (involving a first-refusal right in a joint-operating agreement); El Paso Prod. Co. v. Geomet, Inc., 228 S.W.3d 178, 181 (Tex. App.—Dallas 2007, pet. denied) (involving a first-refusal right in a farm-in agreement and an overriding royalty); Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 581 (Tex. App.—El Paso 2005, pet. denied) (same); McMillan v. Dooley, 144 S.W.3d 159, 165 (Tex. App.—Eastland 2004, pet. denied) (involving a first-refusal right in oil and gas leases); Questa Energy Corp. v. Vantage Point Energy, Inc., 887 S.W.2d 217, 220 (Tex. App.—Amarillo 1994, writ denied) (involving a first-refusal right in a joint-operating agreement); Perritt Co. v. Mitchell, 663 S.W.2d 696, 697 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.) (involving a first-

anything that can be the subject of contracts, including franchise, distributorship, and dealership agreements,[20] shareholder agreements,[21] employment agreements,[22] and joint venture and partnership agreements,[23]

refusal right in an oil and gas lease); Martin v. Lott, 482 S.W.2d 917, 919 (Tex. Civ. App.—Dallas 1972, no writ) (involving a first-refusal right in an overriding royalty); Sibley v. Hill, 331 S.W.2d 227, 228 (Tex. Civ. App.—El Paso 1960, no writ) (involving a first-refusal right in a joint-operating agreement). *See also* Harlan Albright, *Preferential Right Provisions and Their Applicability to Oil and Gas Instruments*, 32 SW. L.J. 803, 803 (1979) ("An important, yet often overlooked, provision commonly included in oil and gas instruments, particularly, joint operating agreements, farm-out agreements, and unit operating agreements, is one providing for a preferential right to purchase." (citations omitted)); Terry I. Cross, *The Ties that Bind: Preemptive Rights and Restraints on Alienation that Commonly Burden Oil and Gas Properties*, 5 TEX. WESLEYAN L. REV. 193, 194–95 (1999) (noting that first-refusal rights "are encountered frequently enough to be an issue in virtually every sale of producing properties" and that they "are typically found in joint operating agreements, occasionally in other agreements affecting joint ownership arrangements, and even in oil and gas leases"); Harry M. Reasoner, *Preferential Purchase Rights in Oil and Gas Instruments*, 46 TEX. L. REV. 57, 57 (1968) (pointing out that first-refusal rights "have long been utilized in the oil business and are contained in the forms suggested in all the standard works on oil and gas").

In fact, four of the five law review articles published by Texas law schools discussing first-refusal rights relate to their use in oil and gas instruments. *See generally* Albright, *supra*; Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability*, 19 TEX. TECH. L. REV. 1263 (1988); Cross, *supra*; Reasoner, *supra*. The fifth relates to first-refusal rights in shareholder agreements. *See generally* Carrie A. Platt, Note, *Right of First Refusal in Involuntary Sales and Transfers by Operation of Law*, 48 BAYLOR L. REV. 1197 (1996).

[20] *E.g.*, *In re* Adelphia Commc'ns Corp., 368 B.R. 348, 350 (Bankr. S.D.N.Y. 2007) (applying New York law); Cavaliere v. Dunkin' Brands, Inc., No. CV-084009199, 2008 WL 1971463, at *2 (Conn. Super. Ct. Apr. 23, 2008); Schupack v. McDonald's Sys., Inc., 264 N.W.2d 827, 829 (Neb. 1978); Tex. State Optical, Inc. v. Wiggins, 882 S.W.2d 8, 9 n.2 (Tex. App.—Houston [1st Dist.] 1994, writ denied); *see also* Peter Siviglia, *Rights of First Refusal*, 66 N.Y. ST. B.J. 56, 56 (1994) (providing a sample first-refusal right "dealing with a new product under a distributorship agreement").

[21] *E.g.*, Seessel Holdings, Inc. v. Fleming Cos., 949 F. Supp. 572, 574 (W.D. Tenn. 1996); Dixie Pipe Sales, Inc. v. Perry, 834 S.W.2d 491, 493 (Tex. App.—Houston [14th Dist.] 1992, writ denied); Consol. Bearing & Supply Co. v. First Nat'l Bank, 720 S.W.2d 647, 650 (Tex. App.—Amarillo 1986, no writ); Platt, *supra* note 19, at 1197.

Article 2.22 § D(1) of the Texas Business Corporation Act expressly authorizes first-refusal rights in shareholder agreements provided that they are conspicuously noted on the stock certificate. Tex. Bus. Corp. Act Ann. art. 2.22 § D (Vernon Supp. 2003).

[22] *E.g.*, Russell v. District of Columbia, 747 F. Supp. 72, 79 (D.D.C. 1990), *aff'd*, 984 F.2d 1255 (D.C. Cir. 1993) (unpublished table decision); ABC v. Wolf, 430 N.Y.S.2d 275, 277 (App. Div. 1980), *aff'd*, 420 N.E.2d 363 (N.Y. 1981).

[23] *E.g.*, Union Pac. Res. Group, Inc. v. Rhône-Poulenc, Inc., 247 F.3d 574, 579 n.8 (5th Cir.

and have burdened everything from film direction[24] and the right to televise a parade[25] to such assets as a natural gas transmission pipeline,[26] a software company,[27] a television station,[28] cable television franchises,[29] a natural gas liquids fractionation plant,[30] an oil storage facility,[31] a petro-chemical plant,[32] an electric-generating plant,[33] television programming,[34] and a racehorse.[35]

A first-refusal right may be for a limited time period, as in a right to purchase the leased premises during a lease's term, or (subject to rules barring perpetuities and other unreasonable restraints on alienation)[36] perpetual, as in the case of a shareholders' agreement or a deed.

First-refusal rights also can be reciprocal or unilateral.[37] Co-owners often create reciprocal agreements in which each owner grants a first-refusal right to, and receives such a right from, the other owners. A shareholders' agreement is typical, and the corporation itself may hold the right, instead of, or in addition to, its shareholders.[38] Reciprocal first-

2001) (involving a first-refusal right in a limited partnership agreement); Robertson v. Murphy, 510 So. 2d 180, 181 (Ala. 1987) (involving a first-refusal right in a real-estate partnership); Park Plaza, Ltd. v. Pietz, 239 Cal. Rptr. 51, 52 (Ct. App. 1987) (involving a first-refusal right in a joint venture agreement to develop a resort hotel), *overruled on other grounds by* Moncharsh v. Heily & Blasé, 832 P.2d 899 (Cal. 1992); Lede v. Aycock, 630 S.W.2d 669, 670 (Tex. App.—Houston [14th Dist.] 1981, writ denied) (involving a first-refusal right in a real-estate partnership).

[24] *E.g.*, Burzynski v. Travers, 636 F. Supp. 109, 111 (E.D.N.Y. 1986).

[25] *E.g.*, CBS, Inc. v. Capital City Commc'ns, Inc., 448 A.2d 48, 51–52 (Pa. Super. Ct. 1982).

[26] *E.g.*, W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1556 (5th Cir. 1990).

[27] *E.g.*, Gleason v. Norwest Mortgage, Inc., 243 F.3d 130, 139 (3d Cir. 2001).

[28] *E.g.*, Miller v. LeSea Broad., Inc., 87 F.3d 224, 225 (7th Cir. 1996).

[29] *E.g.*, *In re* Adelphia Commc'ns Corp., 368 B.R. 348, 351 (Bankr. S.D.N.Y. 2007); Radio Webs, Inc. v. Tele-Media Corp. 292 S.E.2d 712, 715 (Ga. 1982).

[30] *E.g.*, Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 641–42 (Tex. 1996).

[31] *E.g.*, Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1209–10 (5th Cir. 1990).

[32] *E.g.*, Citgo Petroleum Corp. v. Occidental Chem. Corp., No. 99-CV-032-H, 2001 U.S. Dist. LEXIS 25808, at *6 (N.D. Okla. Jan. 22, 2001).

[33] *E.g.*, City of Brownsville v. Golden Spread Elec. Coop., Inc., 192 S.W.3d 876, 878 (Tex. App.—Dallas 2006, pet. denied).

[34] *E.g.*, USA Cable v. World Wrestling Fed'n Entm't, Inc., 766 A.2d 462, 465 (Del. 2000); CBS, Inc. v. Capital City Commc'n, Inc., 448 A.2d 48, 51–52 (Pa. Super. Ct. 1982).

[35] *E.g.*, Guggenheim v. Comm'r, 46 T.C. 559, 564 (1966).

[36] *See infra* Parts VII.A–B (discussing the applicability of the rules against perpetuities and unreasonable restraints on alienation).

[37] David I. Walker, *Rethinking Rights of First Refusal*, 5 STAN. J.L. BUS. & FIN. 1, 12 (1999).

[38] *See generally, e.g.*, Seessel Holdings, Inc. v. Fleming Cos., 949 F. Supp. 572 (W.D. Tenn.

refusal rights also may exist between partners, joint venturers, and co-owners of real or personal property who do not have a corporate or partnership structure.[39] The right may run with the asset and be perpetual and assignable, or it may be a personal right that vanishes on transfer or the holder's death.[40]

Alternatively, the first-refusal right may be unilateral, as illustrated by the example involving Blackacre in subpart II.A *supra*. Such grants typically are contained in real-estate sales agreements, deeds, leases, licenses, and franchise, distributorship, dealership, and employment agreements. In leases; licenses; and franchise, distributorship, and dealership agreements, the right generally will run only for the agreement's term.[41] In the employment context, the right usually extends only for a short period beyond the employment contract's duration.[42]

Alternatives to a first-refusal right based on the terms and conditions of a third party's bona fide offer are a first-refusal right at a fixed priced[43] or a market price, usually set by an independent appraisal.[44] Because of judicial

1996) (involving a shareholders' agreement giving the corporation a first-refusal right on shareholders' stock transfers); Dixie Pipe Sales, Inc. v. Perry, 834 S.W.2d 491, 493 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (involving corporate bylaws giving the corporation a first-refusal right on shareholders' stock transfers); Consol. Bearing & Supply Co. v. First Nat'l Bank, 720 S.W.2d 647, 650 (Tex. App.—Amarillo 1986, no writ) (same); Earthman's, Inc. v. Earthman, 526 S.W.2d 192, 202 (Tex. Civ. App.—Houston [1st Dist.] 1975, no writ) (involving articles of incorporation giving the corporation a first-refusal right on shareholders' stock transfers).

[39] *See, e.g.*, cases cited *supra* note 23 and note 35.

[40] *See infra* Part VI.D.

[41] *See* Megargel Willbrand & Co., L.L.C. v. FAMPAT, L.P., 210 S.W.3d 205, 210 (Mo. Ct. App. 2006) (holding that a right of first refusal in a property interest that runs with the land is assigned or expires with a lease).

[42] Walker, *supra* note 37, at 13.

[43] *See, e.g.*, Inglehart v. Phillips, 383 So. 2d 610, 615–16 (Fla. 1980) (involving a fixed-price, first-refusal right); Brooks v. Terteling, 688 P.2d 1167, 1168 (Idaho 1984) (same); Cole v. Peters, 3 S.W.3d 846, 849 (Mo. Ct. App. 1999) (same); Stratman v. Sheetz, 573 N.E.2d 776, 777 (Ohio Ct. App. 1989) (same); Long v. Wayble, 618 P.2d 22, 24, 25 (Or. Ct. App. 1980) (same); Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 525 (Tex. App.—Amarillo 1998, pet. denied) (same); Foster v. Bullard, 496 S.W.2d 724, 726–27 (Tex. Civ. App.—Amarillo 1973, writ ref'd n.r.e.) (involving a first-refusal right for the purchase of land at the greater of a bona fide offer's per acre price or $750 per acre). *See also* H.G. Fabric Disc., Inc. v. Pomerantz, 515 N.Y.S.2d 823, 824 (App. Div. 1987) (involving a first-refusal right for the lesser of a bona fide offer's price or $200,000).

[44] *See, e.g.*, Drayson v. Wolff, 661 N.E.2d 486, 492 (Ill. App. Ct. 1996); Lorentzen v. Smith, 5 P.3d 1082, 1083 (N.M. 2000); Lin Broad. Corp. v. Metromedia, Inc., 542 N.E.2d 629, 630–31 (N.Y. 1989); Collins v. Collins, No. 13-07-240-CV, 2009 WL 620470, at *3 (Tex. App.—Corpus

hostility to fixed-priced, first-refusal rights,[45] they rarely are used today.

As also intimated above, the first-refusal right typically is granted as one element of a larger transaction—in the above example involving Blackacre, the right was incidental to a real property sale. However, parties can contract solely for a first-refusal right.[46]

C. A First-Refusal Right Is Not an Option

Although often associated with options, the first-refusal right is not a true option.[47] An option is an irrevocable offer that gives its holder a unilateral right to trigger the purchase at the option price during the option period.[48] In contrast, a first-refusal right does not give its holder the power

Christi Mar. 12, 2009, pet. denied); Rolfe v. King, No. 05-03-00357-CV, 2004 WL 784626, at *1 (Tex. App.—Dallas Mar. 29, 2004, no pet.).

[45] Fixed-price first-refusal rights often are unreasonable restraints on alienation. *See infra* Part VIII.B.

[46] To be enforceable, a first-refusal right must be supported by consideration. Trianco v. IBM Corp., 583 F. Supp. 2d 649, 664–65 (E.D. Pa. 2008) (applying New York law), *aff'd*, 2009 U.S. App. LEXIS 22213 (3d Cir. Sept. 17, 2009); Starr v. Wilson, 11 So. 3d 846, 853 (Ala. Civ. App. 2008); Wyatt v. Pezzin, 589 S.E.2d 250, 252 (Ga. Ct. App. 2003); *Abraham Inv.*, 968 S.W.2d at 524; Martin v. Lott, 482 S.W.2d 917, 920 (Tex. Civ. App.—Dallas 1972, no writ); CORBIN, *supra* note 1, § 11.3, at 470. When the right is incidental to a larger transaction, such as a lease, a franchise, a land sale, or an employment contract, the consideration supporting the larger transaction (for example, the rental payments, the franchise fees, the purchase price, or the employment) will support the first-refusal right. *Trianco*, 583 F. Supp. 2d at 664–65; *Starr*, 11 So. 3d at 853; *cf.* 14 TEX. JUR. 3D *Contracts* § 95 (2006) ("If an option is contained in a contract that is itself supported by a sufficient consideration, no other independent consideration is necessary."); CORBIN, *supra* note 1, § 11.7, at 512 (same).

Increasingly, first-refusal rights are created by statute. *E.g.*, Petroleum Marketing Practices Act, 15 U.S.C. § 2802 (2006) (giving a distributor a first-refusal right on its gas station when an oil company terminates its distributorship); D.C. CODE ANN. §§ 42-3404.02–.08. (LexisNexis 2001) (giving residential tenant first-refusal right on leased property when the lessor sells it); FLA. STAT. ANN. § 723.071 (West 2000) (providing homeowners' association with first-refusal right on a mobile park when the owner sells it); IOWA CODE ANN. § 654.16 (West 1995) (providing farm owner with first-refusal right on the farm's foreclosure sale).

[47] *E.g.*, Winberg v. Cimfel, 532 N.W.2d 35, 39 (Neb. 1995) (holding that a first-refusal right "is not a true option"); Procter v. Foxmeyer Drug Co., 884 S.W.2d 853, 859 (Tex. App.—Dallas 1994, no writ) (recognizing a distinction between an option and a first-refusal right); CORBIN, *supra* note 1, § 11.3, at 468–69 ("A right of first refusal is not an option contract."); BRYAN A. GARNER, A DICTIONARY OF MODERN LEGAL USAGE 623 (2d ed.1995) (noting that an option and a first-refusal right "are usefully distinguished in the law of contract").

[48] "Option contracts have two components: (1) an underlying contract that is not binding until accepted; and (2) a covenant to hold open to the optionee the opportunity to accept." Riley v.

to compel an unwilling owner to sell.[49] Rather, it merely requires the owner, when and if it decides to sell, to offer the property first to the holder, usually at the price and on the other terms and conditions set forth in the third party's bona fide offer.[50] However, as noted above, the right "ripens" into an option upon notice to the holder of the grantor's receipt of a bona fide offer and decision to accept it.[51]

D. The Reasons for First-Refusal Rights

Few courts and commentators have considered the motivation for first-refusal rights. Nonetheless, their main rationale clearly derives from the fact that the holder highly values the right's subject matter (for example, because of investments made in the burdened property, as in the case of a license, lease, franchise, or distributorship, or for sentimental reasons, such as a desire to keep the burdened property or business in the family) and wants the right as insurance against a future bargaining breakdown with the grantor.

A first-refusal right can have any of the following non-exclusive purposes: (1) preventing either (a) the sale of property to a person who may use it in an undesirable manner, or (b) the loss of a valuable piece of property, contract, business opportunity, or employee to a competitor; (2) ensuring compatible management of an asset; (3) ensuring continued control over a business or property; or (4) providing an opportunity to purchase a desirable property or to obtain business or a job. Which of these purposes underlie a particular first-refusal right depends, in large measure, on the nature of the parties' relationship.

For example, in the context of a close corporation, a partnership, a joint venture, or the co-ownership of property, the primary motives for a first-refusal right are to assure compatible management, to maintain control (or

Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 188 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.); *accord* Durrett Dev., Inc. v. Gulf Coast Concrete, L.L.C., No. 14-07-01062-CV, 2009 Tex. App. LEXIS 6787, at *10 (Tex. App.—Houston [14th Dist.] Aug. 27, 2009, no. pet. h.); Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 853 (Tex. App.—Dallas 1983, writ ref'd n.r.e.). Generally, an option's price is fixed or is objectively determinable by reference to a public market or an appraisal.

[49] *See Durrett Dev.*, 2009 Tex. App. LEXIS 6787, at *10.

[50] *Id.*; Comeaux v. Suderman, 93 S.W.3d 215, 219 (Tex. App.—Houston [14th District] 2002, no pet.); *Procter*, 884 S.W.2d at 859; *Riley*, 808 S.W.2d at 187; Sanchez v. Dickinson, 551 S.W.2d 481, 484, 485–86 (Tex. Civ. App.—San Antonio 1977, no writ).

[51] *See* cases cited *supra* note 8.

to otherwise protect the co-owners from an interloper), and to provide the current owners with an opportunity to increase their ownership interest if the stock, interest, or property becomes available for purchase at an attractive price.[52] In the context of licenses, leases, franchises, dealerships, or distributorships, the primary motives for such rights are to encourage the licensee, tenant, franchisee, dealer, or distributor to make improvements or investments that it otherwise might not make and to protect the tenant from an undesirable landlord or the licensor, franchisor or grantor from an undesirable licensee, tenant, franchisee, dealer, or distributor.[53] In the employment context, the primary motives for such rights are to prevent the loss of a valuable employee to a competitor (from the employer's viewpoint) and to provide an opportunity for advancement or a job (from the employee's view point).[54]

III. WHAT TRIGGERS THE HOLDERS' RIGHT TO EXERCISE THE FIRST-REFUSAL RIGHT?

Most first-refusal rights are drafted to be triggered when the grantor decides to accept a bona fide offer for the burdened property's sale.[55] This

[52] Questa Energy Corp. v. Vantage Point Energy, Inc., 887 S.W.2d 217, 222 (Tex. App.—Amarillo 1994, writ denied) (discussing the purpose of first-refusal rights in joint operating agreements); Williams Gas Processing-Wamsutter Co. v. Union Pac. Res. Co., 25 P.3d 1064, 1067 n.2 (Wyo. 2001) (same); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. f (2000) (noting that a right of first refusal "may be used to control entry into a development"); FRANK E. EASTERBROOK ET AL., THE ECONOMIC STRUCTURE OF CORPORATE LAW § 7.02 (1991) (discussing the purpose of first-refusal rights in shareholder agreements); Abright, *supra* note 19, at 804–05 (discussing the purpose of first-refusal rights in oil and gas instruments); Conine, *supra* note 19, at 1317 (same); Cross, supra note 19, at 194 (same); Joseph Jude Norton, *Adjustment and Protection of Shareholder Interests in the Closely-Held Corporation in Texas*, 39 SW. L.J. 781, 804 (1985) (discussing the purpose of first-refusal rights in shareholder agreements.

[53] *E.g.*, Reef v. Friday Afternoon, Inc., 73 B.R. 940, 944 (Bankr. D. Mass. 1987) (applying Massachusetts law); Meyer v. Warner, 448 P.2d 394, 397 (Ariz. 1968); Lehn's Court Mgmt. L.L.C. v. My Mouna Inc., 837 A.2d 504, 507 (Pa. Super. Ct. 2003); Nw. Television Club, Inc. v. Gross Seattle, Inc., 612 P.2d 422, 425 (Wash. Ct. App. 1980), *aff'd in part, rev'd in part on other grounds*, 634 P.2d 837 (Wash. 1981), *modified on other grounds*, 640 P.2d 710 (Wash. 1982).

[54] *See* Russel v. District of Columbia, 747 F. Supp. 72, 81 (D.D.C. 1990).

[55] *E.g.*, W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1562 (5th Cir. 1990) (applying Texas law) (involving a first-refusal right in an ownership agreement for a natural gas transmission pipeline); Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 644 (Tex. 1996) (involving a first-refusal right in an operating agreement for a natural gas liquids fractionation plant); First Permian, L.L.C. v. Graham, 212 S.W.3d 368, 369 (Tex. App.—Amarillo 2006, pet. denied) (involving a first-refusal right in an oil and gas lease assignment); Shell v. Austin

standard formulation raises two obvious questions: First, what constitutes a bona fide offer that triggers the first-refusal right; and second, what types of transfers constitute a triggering sale?

Other questions arise when the burdened property is sold either as part of a larger property or as part of a package of properties, such as: Does the proposed transaction trigger the first-refusal right and, if so, what is the price of the burdened property and to what extent must (or can) the holder purchase all of the property that is the subject of the third-party transaction? Also, if the proposed sale does not trigger the right, what becomes of it?

Rehearsal Complex, Inc., No. 03-97-00411-CV, 1998 WL 476728, at *1 n.1 (Tex. App.—Austin Aug. 13, 1998, no pet.) (involving a first-refusal right in a commercial lease); Tex. State Optical, Inc. v. Wiggins, 882 S.W.2d 8, 9 n.2 (Tex. App.—Houston [1st Dist.] 1994, no writ) (involving a first-refusal right in a franchise agreement); Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 186 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.) (involving a first-refusal right in a condominium lease); Stone v. Tigner, 165 S.W.2d 124, 125 (Tex. Civ. App.—Galveston 1942, writ ref'd) (involving a first-refusal right in a grazing lease).

An example of the typical first-refusal right is found in *Riley v. Campeau Homes (Tex.), Inc.*:

> [I]f at any time during the term of this Lease . . . Landlord should receive a bona fide offer from any person . . . to purchase in whole or in part, the Leased Premises, the Landlord shall send Tenant a copy of the proposed Contract and notify Tenant of its intentions to accept the same. Tenant shall have the right within fifteen (15) days of receipt of the proposed Contract to accept the terms of the Contract in writing and within forty-five (45) days thereafter to purchase the above described property . . . for the gross purchase price and on the price and terms specified in said Contract.

808 S.W.2d at 186 (emphasis omitted). *See also Tex. State Optical*, 882 S.W.2d at 9 n.2 ("In the event of a bona fide offer in writing by a Third Party to purchase the office, and [the franchisee] desires to sell on the basis of such bona fide offer, [the franchisee] agrees to first offer the [franchisor] the same opportunity to purchase on the same terms.").

Not all first-refusal rights, however, are tied to a bona fide offer. For example, the first-refusal right in the American Association of Petroleum Landmen's standard operating agreement, Form 610-1989, provides, in pertinent part:

> Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition . . . . The other parties shall than have an optional prior right, for a period of ten days (10) after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell . . . .

Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 529–30 & n.1 (Tex. App.—Waco 2008, pet. denied).

A. What Constitutes a Bona Fide Offer?

In *Jones v. Riley*,[56] the former Fort Worth Court of Civil Appeals discussed what constitutes a bona fide offer:

> [I]n order for [an] offer to constitute a "bona fide offer" . . . such offer had to not only be made in good faith, but it had to also be of such a nature and in such a form that it could be, by an acceptance thereof by the offeree, caused to ripen into a valid and binding contract that could be enforced by any party to it.
>
> To come within the meaning of the phrase "bona fide offer" the offer would have to be one that was legally valid.[57]

Courts in Texas and other jurisdictions have cited *Jones'* definition of bona fide offer.[58]

Courts outside Texas, without citing *Jones*, have similarly defined the term. For example, the Vermont Supreme Court, in the context of a first-refusal right, recently defined a bona fide offer as one made "'honestly and with a serious intent' where 'the offeror genuinely intends to bind itself to pay the offered price.'"[59]

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[56] 471 S.W.2d 650 (Tex. Civ. App.—Fort Worth 1971, writ ref'd n.r.e.).

[57] *Id.* at 658–59.

[58] *E.g.*, Ray v. Lancaster Inv. Group, No. 05-93-01857-CV, 1994 Tex. App. LEXIS 4045, at *14 (Tex. App.—Dallas Aug. 5, 1994, no writ) (not designated for publication) (involving offer to purchase a building); Baldwin v. New, 736 S.W.2d 148, 152 (Tex. App.—Dallas 1987, writ denied) (same); Lede v. Aycock, 630 S.W.2d 669, 674 (Tex. App.—Houston [14th Dist.] 1981, writ denied) (involving a first-refusal right); DCM Inv. Corp. v. Pinecrest Inv. Co., 34 P.3d 785, 788–89 (Utah 2001) (same).

[59] Rappaport v. Banfield, 924 A.2d 72, 79 (Vt. 2007) (quoting Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 963 (Mass. 2004)). *See also* Hartzheim v. Valley Land & Cattle Co., 62 Cal. Rptr. 3d 815, 823 (Ct. App. 2007) ("Generally speaking, it is the concurrence of both an arms' length transaction and change in control of the property that characterizes a bona fide sale."); Schroeder v. Duenke, 265 S.W.3d 843, 848 (Mo. Ct. App. 2008) ("Under Missouri law, a bona fide offer is one that is made in good faith, by a person with good judgment and acquainted with the value of the property, with sufficient ability to pay in cash, and based upon fair market value."); Story v. Wood, 569 N.Y.S.2d 487, 489 (App. Div. 1991) (defining a "good-faith offer" in the context of a first-refusal right as "(1) a genuine outside offer rather than one contrived in concert with the seller solely for the purpose of extracting a more favorable price from the holder . . . and (2) an offer which [the grantor] honestly is willing to accept" (citations omitted)); Shepherd v. Davis, 574 S.E.2d 514, 521 (Va. 2003) (holding that the

Although these definitions expressly identify only two elements—"good faith" and a "firm" offer—the case law clearly indicates that a third element exists.[60] That is, the offer must be made in an arm's length transaction resulting in a change of control over the burdened property.[61] Accordingly, a bona fide offer for purposes of triggering a first-refusal right must be (1) made in good faith; (2) a firm one; and (3) made in an arm's length transaction resulting in a change of control over the burdened property.[62]

Although the concept of good faith is an elusive one, having different meanings in different contexts,[63] a good-faith offer, in the context of a first-refusal right, is one made honestly, sincerely, and without intent to defraud

term "bona fide" for purposes of a third-party offer for property burdened by a first-refusal right "is defined as '[m]ade in good faith; without fraud or deceit'" (quoting BLACK'S LAW DICTIONARY 168 (7th ed. 1999)).

[60] *See infra* note 61.

[61] *See, e.g.*, Creque v. Texaco Antilles Ltd., 409 F.3d 150, 155 (3d Cir. 2005) (applying Virgin Islands law) ("A right of first refusal to purchase real property is not triggered by the mere conveyance of that property. Only when the conveyance is marked by arms' length dealing and a change in control of the property may that right be exercised."); Kroehnke v. Zimmerman, 467 P.2d 265, 267 (Colo. 1970) (requiring an arm's length transaction to trigger first-refusal right); Fina Oil & Chem. Co. v. Amoco Prod. Co., 673 So. 2d 668, 672 (La. Ct. App. 1996) (holding that, in determining whether an offer is "bona fide," "courts have generally placed emphasis on either the presence or absence of arm's length dealing between the owner of the burdened interest and the third-party transferee or upon the effect of the conveyance as placing the property beyond the reach of the holder of the right"); LaRose Mkt., Inc. v. Sylvan Ctr., Inc., 530 N.W.2d 505, 509 (Mich. Ct. App. 1995) ("For purposes of a right of first refusal a 'sale' occurs upon the transfer (a) for value (b) of a significant interest in the subject property (c) to a stranger to the lease, (d) who thereby gains substantial control over the leased property." (quoting Prince v. Elm Inv. Co., 649 P.2d 820, 823 (Utah 1982))); Belliveau v. O'Coin, 557 A.2d 75, 78 (R.I. 1989) (requiring an arm's length transaction to trigger a first-refusal right); *DCM Inv. Corp.*, 34 P.3d at 789 (Utah 2001) (holding that "[o]ther factors may assist the court in determining the bona fides of an offer, including (1) the relationship of the parties (e.g., whether the parties have competing interests), (2) whether the transaction was made under duress, (3) whether the transaction occurred in the open market, (4) whether the offer approximates fair market value, and (5) whether there are any elements of fraud or misrepresentation involved"); McGuire v. Lowery, 2 P.3d 527, 532 (Wyo. 2000) (same); Abright, *supra* note 19, at 811 (explaining that in deciding whether a sale has occurred, most courts "place[] emphasis on . . . the presence or absence of arm's length dealing between the owner of the burdened interest and the third party transferee").

[62] *See supra* note 61.

[63] *E.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1979) ("The phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat with the context."); ROGER BROWN ET AL., GOOD FAITH IN CONTRACTS: CONCEPT AND CONTEXT 3 (1999) ("[G]ood faith is an elusive idea, taking on different meanings and emphases as we move from one context to another . . . .").

or take unconscionable advantage of the grantor.[64]

To be firm, the offer must be one that is legally valid and capable of acceptance by the grantor.[65] Accordingly, preliminary negotiations do not trigger a first-refusal right:

> It is well-settled, as a matter of both law and common sense, that parties must be permitted to engage in substantive, non-binding negotiations without triggering the provisions of a right of first refusal. . . . This unremarkable proposition compels the conclusion that an unenforceable collection of negotiated terms, which together constitute neither a "contract," an "agreement," nor a "lease," cannot then be an "other arrangement" that triggers the first-refusal right.[66]

[64] Tex. Bus. & Com. Code Ann. § 1.201(20) (Vernon 2009) (Uniform Commercial Code defining "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing"); Preston Nat'l Bank v. Schutze, 2004 Bankr. LEXIS 584, at *6–7 (Bankr. N.D. Tex. May 4, 2004) (mem. op.) (defining "bona fide" as "made in good faith, without fraud or deceit . . . . Sincere, genuine." (quoting BLACK'S LAW DICTIONARY 168 (7th ed. 1999))); *Story*, 569 N.Y.S.2d at 489; Cent. Am. Aviation Servs., S.A. v. Bell Helicopter Textron, Inc., No. 02-06-126-CV, 2007 Tex. App. LEXIS 1469, at *18 (Tex. App.—Fort Worth Mar. 1, 2007, no pet.) (defining "good faith" as "a state of mind consisting in (1) honesty in belief or purpose . . . or (4) absence of intent to defraud or to seek unconscionable advantage" (quoting BLACK'S LAW DICTIONARY 713 (8th ed. 2004))); Bennett v. Computer Assocs. Int'l, Inc., 932 S.W.2d 197, 202 (Tex. App.—Amarillo 1996, writ denied) (defining "good faith" as "honesty in fact"); MBank Grand Prairie v. State, 737 S.W.2d 424, 427 (Tex. App.—Fort Worth 1987, no writ) (defining "bona fide" as "[i]n or with good faith; . . . without deceit or fraud" (quoting BLACK'S LAW DICTIONARY 160 (5th ed. 1979))); *Shepherd*, 574 S.E.2d at 521.

An offer by a third party, who clearly lacks the financial ability to consummate the transaction is not bona fide. *E.g.*, Smith v. Bertram, 603 N.W.2d 568, 573–74 (Iowa 1999); Imperial Refineries Corp. v. Morrissey, 199 N.W.2d 872, 878 (Iowa 1963); Shell Oil Co. v. Kapler, 50 N.W.2d 707, 712–13 (Minn. 1951). For example, in *Imperial Refineries Corp. v. Morrissey*, the Iowa Supreme Court affirmed a jury verdict that a priest's offer to purchase property from his mother for $60,000 was not a bona fide one that triggered a first-refusal right because the priest's salary was $1,000 per year and he had no appreciable assets. 119 N.W.2d at 713; *see also* LDC-728 Milwaukee, L.L.C. v. Raettig, 727 N.W.2d 82, 86–87 (Wis. Ct. App. 2006) (holding that the holder breached a first-refusal right when he exercised it knowing that he could not purchase the burdened property).

[65] *See* BLACK'S LAW DICTIONARY 1113 (8th ed. 2004) (defining "offer").

[66] Citgo Petroleum Corp. v. Occidental Chem. Corp., No. 99-CV-032-H, 2001 U.S. Dist. LEXIS 25808, at *11 (N.D. Okla. Jan. 22, 2001); *accord* Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 645 (Tex. 1996) ("Preliminary negotiations between offerors and potential

In contrast, a conditional offer triggers a first-refusal right, if the condition is one that can be met.[67]

Although no court applying Texas law, either in the context of a first-refusal right or otherwise, has defined what constitutes an "arm's length transaction," courts from other jurisdictions have done so in non-first-refusal right contexts. For example, the United States Bankruptcy Court for the Northern District of Ohio has defined an "arm's length transaction" as one "characterized by the following elements: It is voluntary, i.e., without compulsion or duress, it generally takes place in an open market, and the parties are acting in their own self-interest."[68] Thus, as discussed in subpart

purchasers do not trigger preemptive rights.").

A prospective purchaser may not want to expend the time and effort to negotiate and draft a purchase contract or offer only to be preempted by the holder of a first-refusal right. Thus, early in the negotiation process, the third party may demand that the grantor ask the holder to waive its first-refusal right as a condition to the third party making a purchase offer or submitting a purchase contract. Courts generally hold that such a request is insufficient to trigger the right. *E.g.*, Wyman v. Leikam, 480 P.2d 97, 99 (Wyo. 1971).

Moreover, on occasion, a lessor-grantor will receive an offer to purchase leased property conditioned on the termination of the holder-tenant's lease. The general rule is that, absent language to the contrary in the lease or the first-refusal right, the tenant-holder's rejection of the third party's offer does not terminate the tenant-holder's lease. *E.g.*, Sexton v. Nelson, 39 Cal. Rptr. 407, 416 (Ct. App. 1964); Eaton v. Fisk, 584 N.Y.S.2d 280, 281 (App. Div. 1992); Marshall v. Summers, 934 S.W.2d 647, 650–53 (Tenn. Ct. App. 1996); Golden Spread Oil, Inc. v. Am. Petrofina Co., 431 S.W.2d 50, 52–53 (Tex. Civ. App.—Amarillo 1968, writ ref'd n.r.e.).

[67] Mucci v. Brockton Bocce Club, Inc., 472 N.E.2d 966, 968 (Mass. App. Ct. 1985); *Story*, 569 N.Y.S.2d at 489; Nw. Television Club, Inc. v. Gross Seattle, Inc., 634 P.2d 837, 840 (Wash. 1981), *modified on other grounds*, 640 P.2d 710 (Wash. 1982); *see also* Weisser v. Wal-Mart Real Estate Bus. Trust, No. 04-15, 2005 U.S. Dist. LEXIS 11185, at *22–27 (E.D. Ky. June 8, 2005) (involving conditional third-party offer); H.G. Fabric Disc., Inc. v. Pomerantz, 515 N.Y.S.2d 823, 825 (App. Div. 1987) (holding that third party's offer to purchase building conditioned on building being vacant did not trigger first-refusal right because the building was occupied and, therefore, the condition was impossible to meet).

[68] Cedar View, Ltd. v. Colpetzer, No. 5:05-CV-00782, 2006 WL 456482, at *2 (N.D. Ohio Feb. 24, 2006) (applying Ohio law); *accord* Crème Mfg. Co. v. United States, 492 F.2d 515, 520 (5th Cir. 1974) (holding that "[t]o be at arm's length under [the manufacturer's excise statute] a transaction must be between parties with adverse economic interests. Each party to the transaction must be in a position to distinguish his economic interest from that of the other party and, where they conflict, always choose that to his individual benefit." (citation and internal quotation omitted)).

An arm's length transaction necessarily assumes that the parties have relatively equal bargaining power. *E.g.*, Allegheny Ludlum Corp. v. United States, 367 F.3d 1339, 1348 (Fed. Cir. 2004) (A negotiation or transaction is conducted at "arm's length" if it is "between two parties who are not related or not on close terms and who are presumed to have roughly equal bargaining

III.B, transactions between related parties generally are not arm's length.

The fact that the purchase price in the third party's offer is above or below the property's fair market value is relevant to the offer's bona fide status depending on the surrounding circumstances.[69] For example, if the offer is from a related party and is motivated by the desire to deprive the holder of its first-refusal right or to force the holder to purchase the burdened property at an inflated price, the offer will not be found to be bona fide.[70] Similarly, when a property burdened by a first-refusal right is sold as part of a package of properties or as part of a larger parcel, and the third party either alone or with the grantor allocates a grossly disproportionate portion of the purchase price for the entire package or parcel to the burdened property, the offer likely will not be bona fide.[71]

In contrast, in an arm's length transaction involving only the burdened property, an offer above—even one substantially above fair market value—should be found to be bona fide even if the price was inflated to defeat the first-refusal right. As the Vermont Supreme Court recently held:

> A prospective buyer may inflate the price for a parcel, or be motivated by a desire to defeat a right of first refusal, and still make a bona fide offer. As the Massachusetts Supreme Judicial Court recognized,

power"); BLACK'S LAW DICTIONARY 123 (9th ed. 2009) (same).

A grantor seeking to avoid triggering a first-refusal right, however, should not rely too heavily on a "relatively-equal-bargaining-power" requirement. The Texas Supreme Court recently suggested that an actionable disparity in bargaining power exists only "when one party has no choice but to accept an agreement limiting the liability of another party. . . . [A] bargain is not negated because one party may have been in a more advantageous bargaining position. Rather, we consider whether a contract results in unfair surprise or oppression." *In re* Lyon Fin. Servs., Inc., 257 S.W.3d 228, 232–33 (Tex. 2008) (rejecting argument that a forum selection clause was unenforceable because, among other reasons, it was contained in a lease offered to the plaintiff on a "take-it-or-leave-it basis").

[69] *E.g.*, Raytheon Co. v. Rheem Mfg. Co., 322 F.2d 173, 178–80 (9th Cir. 1963) (applying California law); Schroeder v. Duenke, 265 S.W.3d 843, 848 (Mo. Ct. App. 2008); DCM Inv. Corp. v. Pinecrest Inv. Co., 34 P.3d 785, 789 (Utah 2001).

[70] *E.g.*, *Raytheon*, 322 F.2d at 178–82 (holding that an offer by a grantor's parent corporation to buy certain manufacturing equipment burdened by a first-refusal right solely to force the holder to purchase it at an inflated price was not a bona fide offer); *Story*, 569 N.Y.S.2d at 489 (noting that for an offer to be a "good-faith offer" in the context of a first-refusal right it must, among other things, be "a genuine outside offer rather than one contrived in concert with the seller solely for the purpose of extracting a more favorable purchase price from the holder").

[71] *See infra* Part V.F.

> Inherent in a right of first refusal is the fact that a third party, not the holder of the right, will dictate the price, and the holder therefore runs the risk that the third party will agree to a price that is above market value, or that is above what the holder is willing and able to pay.
>
> The question is whether the purchaser honestly intended to be bound by its offer.[72]

An offer below fair market value is bona fide only if the proposed transaction is an arm's length one.[73] Thus, for example, the sale of burdened property to a grantor's relative[74] or to a corporation related to, or controlled by,[75] the grantor for less than the property's fair market value likely will not be the result of a bona fide offer.

B. What Transactions Constitute a Sale?

Because most first-refusal rights are drafted to be triggered by the grantor's desire to sell the burdened property or words to similar effect (e.g., decides, elects, or intends to sell), questions arise regarding whether

[72] *Rappaport*, 924 A.2d at 79 (citations omitted) (quoting Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 963 (Mass. 2004)); *see* Shepherd v. Davis, 574 S.E.2d 514, 521 (Va. 2003) (rejecting argument that a third party's offer was not bona fide because its terms "were designed to make it unreasonable for him to purchase the [p]roperty").

[73] While not much authority exists, Texas cases suggest that, in an arm's length transaction, virtually any sale for value will trigger the first-refusal right. *E.g.*, Cherokee Water Co. v. Forderhause, 641 S.W.2d 522, 525 (Tex. 1982) (holding that first-refusal right was triggered by an oil and gas lease); Mandell v. Mandell, 214 S.W.3d 682, 688 (Tex. App.—Houston [14th Dist.] 2007, no pet.) (holding that first-refusal right was triggered by the transfer of burdened property to attorney in part payment of a contingent fee); A.G.E., Inc. v. Buford, 105 S.W.3d 667, 671, 673 (Tex. App.—Austin 2003, pet. denied) (same); IMCO Oil & Gas Co. v. Mitchell Energy Corp., 911 S.W.2d 916, 921 (Tex. App.—Fort Worth 1995, no writ) (holding that first-refusal right was triggered by the grant of an overriding royalty); Sanchez v. Dickinson, 551 S.W.2d 481, 487 (Tex. Civ. App.—San Antonio 1977, no writ) (holding that first-refusal right was triggered by an oil and gas lease). *See also* Barela v. Locer, 708 P.2d 307, 310 (N.M. 1985) (holding that first-refusal right was triggered by an oil and gas lease).

[74] *E.g.*, Issacson v. First Sec. Bank of Utah, 511 P.2d 269, 272 (Idaho 1973) (holding that the burdened property's conveyance to the grantor's son for a third of its fair market value was more in the nature of a gift than a sale and, therefore, did not trigger the first-refusal right); Schroeder v. Duenke, 265 S.W.3d 843, 848 (Mo. Ct. App. 2008) (holding that a fact issue existed regarding whether parent's sale of family's house to son for less than its appraised value was "bona fide").

[75] *See infra* notes 95–98.

the right is triggered by: (1) a gift of the property; (2) the property's involuntary transfer pursuant to, for example, a foreclosure sale, a deed in lieu of foreclosure, a condemnation order, or a divorce decree; (3) the property's transfer by operation of law after the grantor's death either by will or intestate succession; (4) the property's sale or conveyance between a corporation and its shareholder(s) or between corporate affiliates; (5) a merger or other change in control of a grantor-corporation; and (6) the property's sale from one co-owner to another. Each of these types of transactions is examined below.

1. A Gift of the Burdened Property

Although no Texas case has considered the issue, courts from other jurisdictions uniformly hold that the typical first-refusal right, which is triggered by the grantor's decision to accept a bona fide offer for the property's sale, is not triggered by the giving of burdened property as a gift.[76] A sale requires the grantor to receive consideration for the property's

[76] *E.g.*, Cottrell v. Beard, 9 S.W.3d 568, 571 (Ark. 2000) (holding that a gift of the burdened property did not trigger a first-refusal right conditioned on the property's sale); Hartzheim v. Valley Land & Cattle Co., 62 Cal. Rptr. 3d 815, 822 (Ct. App. 2007) ("A gift of the property to third parties . . . does not trigger a typical right of first refusal."); Webster v. Ocean Reef Cmty. Ass'n, 944 So. 2d 367, 370 (Fla. Dist. Ct. App. 2008) ("Were we to construe 'sale' or 'purchase' to include [the grantor's] transfer and her residential trust's transfer, the [holder] would have a right of first refusal to acquire the residence for nothing, nada, zero. We will not construe the documents to produce an absurd result."); *Issacson*, 511 P.2d at 272 (holding that a first-refusal right was not triggered by grantor's gift of the burdened property to his son); Rucker Props., L.L.C. v. Friday, 204 P.3d 671, 676 (Kan. Ct. App. 2009) ("[B]ecause the conveyance . . . was an intra-family gift and not a sale and no ownership was transferred to anyone outside of the lease agreement, the right of first refusal was not triggered."); Minton v. Crawford, 719 So. 2d 743, 745–46 (La. Ct. App. 1998) (holding that the burdened property's gift to the grantor's children did not trigger a first-refusal right); Park Station Ltd. P'ship, L.L.L.P. v. Bosse, 835 A.2d 646, 653 (Md. 2003) (holding that burdened property's gift to a charitable fund did not trigger a first-refusal right); *Schroeder*, 265 S.W.3d at 847 ("Under Missouri law, a transfer of property by gift from one family member to another does not trigger a right of first refusal."); Mericle v. Wolf, 562 A.2d 364, 368 (Pa. Super. Ct. 1989) (holding that burden property's gift to a hospital did not trigger a first-refusal right); Bennett v. Dove, 277 S.E.2d 617, 619 (W. Va. 1981) ("The [first-refusal right holders] used the words 'desires to sell' to express their intent. 'Sell' is commonly and ordinarily understood to mean an act of giving up property for money that the buyer either pays or promises to pay in the future, and we must conclude that [the grantor] did not sell the property when he gave it to two of his children." (citation omitted)); Dewey v. Dewey, 33 P.3d 1143, 1149 (Wyo. 2001) ("[A] 'sale' in the context of a right of first refusal is a 'transfer for value of a significant interest in the subject property to a stranger who thereby gains substantial [ownership or] control over the subject property.'" (quoting Prince v. Elm Inv. Co., 649 P.2d 820,

conveyance.[77] The fact that a grantor makes the gift to receive a charitable deduction under the tax laws does not change the analysis.[78]

2. Involuntary Transfers and Transfers by Operation of Law

The majority of cases, including Texas cases, hold that involuntary transfers, pursuant to a foreclosure sale,[79] a deed in lieu of foreclosure,[80] a condemnation order,[81] a divorce decree,[82] or a transfer by operation of law

823 (Utah 1982))). *But see* Warden v. Taylor, 333 A.2d 922, 923 (Pa. 1975) (holding that a gift of property triggered first-refusal right because the right was conditioned on either the "sale" or "conveyance" of the property).

[77] Tex. Bus. & Com. Code Ann. § 2.106(1) (Vernon 2009) (defining "sale" for purposes of the Uniform Commercial Code as the "passing of title from the seller to the buyer for a price"); *Cottrell*, 9 S.W.3d at 571 ("A sale is a contract by which one party transfers the ownership of property to another for a price."); *Park Station*, 835 A.2d at 652 ("[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.'"); *Cherokee Water Co.*, 641 S.W.2d at 525 ("The term 'sale,' when used in a property context, is commonly understood to mean any conveyance of an estate for money or money's worth."); Galveston Terminals, Inc. v. Tenneco Oil Co., 904 S.W.2d 787, 791 (Tex. App.—Houston [1st Dist.] 1995) ("The term 'sale,' when used in a property context means a conveyance of an estate for money . . . ."), *set aside without reference to the merits*, 922 S.W.2d 549 (Tex. 1996), *disapproved on other grounds*, Tenneco, Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 645 (Tex. 1996); Mark D. Christiansen, *Preferential Right of Purchase Issues in Oil and Gas Property Sales*, 10 NAT. RESOURCES & ENV'T 35, 35–36 (1996) (recognizing rights of first refusal often refer to a sale, which commonly means a conveyance for money).

[78] *E.g.*, *Park Station*, 835 A.2d at 651 (finding a collateral benefit to the grantor in the form of a tax deduction was not sufficient to make the burdened property's conveyance a sale).

[79] *E.g.*, Draper v. Gochman, 400 S.W.2d 545, 548 (Tex. 1966); Consol. Bearing & Supply Co. v. First Nat'l Bank, 720 S.W.2d 647, 650–51 (Tex. App.—Amarillo 1986, no writ); *see also* Tadros v. Middlebury Med. Ctr., Inc., 820 A.2d 230, 235 (Conn. 2003); Equitable Trust Co. v. O'Neill, 420 A.2d 1196, 1200–01 (Del. Super. Ct. 1980); Henderson v. Millis, 373 N.W.2d 497, 503 (Iowa 1985); CORBIN, *supra* note 1, § 11.3, at 476 n.17.

[80] *E.g.*, Pellandini v. Valadao, 7 Cal. Rptr. 3d 413, 416 (Ct. App. 2003).

[81] *E.g.*, Campbell v. Alger, 83 Cal. Rptr. 2d 696, 700 (Ct. App. 1999); Kowalsky v. Familia, 336 N.Y.S.2d 37, 43 (Sup. Ct. 1972); *see* CORBIN, *supra* note 1, § 11.3, at 476 n.17 ("A holder . . . cannot exercise the right against a buyer at a forced sale . . . because the condition precedent (the third-party offer and decision to accept it) has not occurred.").

[82] *E.g.*, Earthman's, Inc. v. Earthman, 526 S.W.2d 192, 202 (Tex. Civ. App.—Houston [1st Dist.] 1975, no writ). *But see* Dixie Pipe Sales, Inc. v. Perry, 834 S.W.2d 491, 494 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (holding that a first-refusal right was triggered by stock's transfer on the shareholder's death because the shareholders' agreement applied to any "disposition" of the stock).

after the grantor's death either by will or intestate succession[83] do not trigger the typical first-refusal right. The leading Texas case is *Draper v. Gochman*.[84]

In *Draper*, the first-refusal right gave a sublessee a preferential right to purchase the leasehold if the "lessor desires to sell or dispose of his interest" in the property.[85] After the lessor defaulted on its mortgage, the property was sold at foreclosure.[86] The Texas Supreme Court held that the first-refusal right was not triggered by the foreclosure sale because it was "involuntary."[87]

The same result was reached by the Connecticut Supreme Court in *Tadros v. Middlebury Medical Center, Inc.*[88] There, a warranty deed gave the holder a first-refusal right on certain real property if the grantor "form[ed] the intention" to sell the property pursuant to a bona fide offer.[89] After the property was sold at foreclosure, the holder sought to exercise its first-refusal right against the winning bidder at the foreclosure sale.[90] In holding that the foreclosure sale did not trigger the right, the Connecticut Supreme Court reasoned:

> Under the plain language of the terms of the agreement in the present case, [the holder] . . . could exercise the right of first refusal only if one of two conditions were met. First, [the holder's] right would be triggered if the grantees "form[ed] the intention" of selling the premises. Second, [the holder] could exercise its right of first refusal if the grantees accepted a bona fide, written offer to purchase the property. Neither of these conditions was met in the present case.

[83] *E.g.*, Brooks v. Terteling, 688 P.2d 1167, 1169 (Idaho 1984).

[84] 400 S.W.2d 545 (Tex. 1966).

[85] *Id.* at 545.

[86] *Id.*

[87] *Id.* at 547. The Texas Supreme Court in *Draper* also held that the execution of a deed of trust for the burdened property did not constitute a sale because it did not pass title to the property. Rather, title remained in the grantor, and the deed of trust's beneficiary merely had a lien. *Id.*; *accord* Consol. Bearing & Supply Co. v. First Nat'l Bank, 720 S.W.2d 647, 650–51 (Tex. App.—Amarillo 1986, no writ) (holding that neither a pledge of stock nor its subsequent sale at foreclosure triggered a first-refusal right).

[88] 820 A.2d 230 (Conn. 2003).

[89] *Id.* at 233.

[90] *Id.* at 233–34.

> The first condition was not met because there is no evidence that [the grantor] formed the intention to sell the property. [The grantor] did not sell the property; rather, the court-appointed committee was the seller for purpose of the foreclosure action brought by [the grantor's lender]. Moreover, common sense dictates that, because [the lender] was forced to bring a foreclosure sale for nonpayment, the sale was not voluntary and [the grantor] had no intention to sell the property.
>
> The second condition to the exercise of the right of first refusal, namely, the acceptance of a bona fide, written offer to sell the premises, also was not met. The committee did not accept a bona fide, written offer to purchase the property; rather it sold the property in accordance with a court order to conduct a foreclosure sale. Thus, because the committee did not accept any bona fide, written offer to purchase the property, the second condition to the exercise of [the holder's] right of first refusal did not occur. On the basis of the plain language of the deed retaining the right of first refusal, therefore, the right did not apply within the context of the foreclosure sale conducted by the committee.[91]

3. Transfers Between a Corporation and its Shareholders or Corporate Affiliates, Mergers, and Changes in Control of a Grantor-Corporation

Holders often claim that the terms "conveyance," "transfer," or "sale," as used in a first-refusal right, extend to any transaction resulting in the burdened property's transfer.[92] Thus, they often seek to exercise the right when: (1) the property is transferred between a corporation and its shareholder(s) or between corporate affiliates; (2) a third party purchases a controlling interest in the grantor-corporation's stock; or (3) the grantor-corporation is merged into another corporation.[93] As discussed below, these

[91] *Id.* at 235; *accord Earthman*, 526 S.W.2d at 202 (recognizing, a first-refusal right generally "is inapplicable to a transfer occurring as a result of an involuntary sale or by operation of law unless by specific provision in the restriction it is made applicable").

[92] *See infra* notes 94–109.

[93] *See infra* notes 94–109.

types of transactions do not trigger the typical first-refusal right.

Courts in Texas and other jurisdictions almost uniformly hold that a sale or conveyance of the burdened property between either a corporation and its shareholder(s) or corporate affiliates does not trigger the typical first-refusal right.[94] The rationale for this rule is that such a sale or conveyance is not an arm's length transaction and results in no real change in control over the burdened property.

For example, in *Creque v. Texaco Antilles Ltd.*,[95] after all the assets of a subsidiary, including certain property burdened by a first-refusal right, were sold to another subsidiary of the same corporation for tax reasons, the holder sued, claiming that the sale triggered her first-refusal right.[96] After

[94] Questa Energy Corp. v. Vantage Point Energy, Inc., 887 S.W.2d 217, 222 (Tex. App.—Amarillo 1994, writ denied) (holding that burdened property's transfer by subsidiary to parent corporation did not trigger first-refusal right); *see, e.g.*, Evans v. SC Southfield Twelve Assocs., 208 Fed. Appx. 403, 408–09 (6th Cir. 2006) (applying Michigan law) (holding that burdened property's transfer by grantors to limited liability company owned by them did not trigger first-refusal right); *see also* Creque v. Texaco Antilles Ltd., 409 F.3d 150, 155 (3d Cir. 2005) (applying Virgin Islands law) (holding that burdened property's transfer from one subsidiary to another for tax reasons did not trigger first-refusal right); Roeland v. Trucano, 214 P.3d 343, 352 (Alaska 2009) (concluding that burdened property's transfer from grantor corporation to limited liability company owned by the corporation's shareholder did not trigger first-refusal right); Hartzheim v. Valley Land & Cattle Co., 62 Cal. Rptr. 3d 815, 824 (Ct. App. 2007) (holding that the burdened property's sale to the grantors' children and grandchildren for tax and estate planning purposes did not trigger first-refusal right); Kroehnke v. Zimmerman, 467 P.2d 265, 267 (Colo. 1970) (holding that burdened property's conveyance by individual grantors to their wholly-owned corporation did not trigger first-refusal right); Wallasey Tenants Ass'n v. Varner, 892 A.2d 1135, 1141 (D.C. 2006) (holding that burdened property's transfer to grantor's limited liability company for liability and estate planning reasons did not trigger first-refusal right); Sand v. London & Co., 121 A.2d 559, 562 (N.J. Super. Ct. App. Div. 1956) (holding that burdened property's conveyance by grantor-corporation to an affiliate did not trigger first-refusal right); Lehn's Court Mgmt. LLC v. My Mouna Inc., 837 A.2d 504, 511 (Pa. Super. Ct. 2003) (holding that burdened property's conveyance from limited liability company to the company's owner did not trigger first-refusal right); Belliveau v. O'Coin, 557 A.2d 75, 78–79 (R.I. 1989) (holding that burdened property's conveyance by an individual grantor to her wholly-owned corporation did not trigger first-refusal right); McGuire v. Lowery, 2 P.3d 527, 532 (Wyo. 2000) (holding that the burdened property's conveyance by individual grantors to their wholly-owned corporation did not trigger first-refusal right). *But see* Auntie Ruth's Furry Friends' Home Away from Home, Ltd. v. GCC Prop. Mgmt., LLC, No. A08-1602, 2009 Minn. App. Unpub. LEXIS 1030, at *10–11 (Minn. Ct. App. Sept. 15, 2009) (alternatively holding that the burdened property's transfer from grantor corporation to another corporation owned by the same shareholders triggered first-refusal right and expressly rejecting contrary "foreign case law").

[95] 409 F.3d 150 (3d Cir. 2005).

[96] *Id.* at 151–52.

examining cases from other jurisdictions because none existed from either the Third Circuit or the Virgin Islands, whose law was controlling,[97] the United States Court of Appeals for the Third Circuit held that the property's sale did not trigger the right:

> A right of first refusal to purchase real property is not triggered by the mere conveyance of that property. Only when the conveyance is marked by arms' length dealing and a change in control of the property may that right be exercised. Where, as here, a corporation conveys property from one of its wholly-owned subsidiaries to another in good faith for a legitimate business purpose, there has been no bona fide third party offer sufficient to trigger a right of first refusal on the property. Therefore, the condition precedent to [the holder's] exercise of her right of first refusal has not yet been satisfied.[98]

Of course, if the transfer results in a true change of control of the property, the right is triggered. Thus, in *Prince v. Elm Investment Co.*,[99] the Utah Supreme Court held that a transfer of the burdened property by the grantor-owner to a partnership that the grantor-owner did not control triggered the first-refusal right.[100]

Most courts, including Texas courts, also hold that a typical first-refusal right is not triggered by a change in control over a grantor-corporation because such a transaction does not result in the burdened property's transfer.[101] For example, in *Tenneco Inc. v. Enterprise Products Co.*,[102] Tenneco Oil Company and four other entities owned a natural gas liquids fractionation plant. The parties' joint operating agreement contained a first-refusal right requiring each owner to offer its interest in the plant to the

[97] *Id.* at 153–54.

[98] *Id.* at 155 (citations and footnote omitted). *See also supra* note 94. Of course, after the transfer the holder's first-refusal right remains intact. *E.g.*, *Creque*, 409 F.3d at 155 n.4; *Lehn's Court Mgmt.*, 837 A.2d at 511.

[99] 649 P.2d 820 (Utah 1982).

[100] *Id.* at 823; *accord* Auntie Ruth's Furry Friends' Home Away from Home, Ltd. v. GCC Prop. Mgmt., LLC, No. A08-1602, 2009 Minn. App. Unpub. LEXIS 1030, at *10–11 (Minn. Ct. App. Sept. 15, 2009) (alternatively holding that burdened property's transfer from grantor corporation to another corporation with a new shareholder triggered a first-refusal right).

[101] *See, e.g.*, *Creque*, 409 F.3d at 155.

[102] 925 S.W.2d 640 (Tex. 1996).

other owners before selling it to an unrelated third party.[103] After the parties signed the agreement, Tenneco Oil conveyed its interest in the plant to Tenneco Natural Gas Liquids Corporation, one of its wholly owned subsidiaries, and then sold all of Tenneco Natural Gas Liquids' stock to Enron Natural Gas Liquids Corporation, which, in turn, sold the stock to another Enron affiliate.[104]

The plant's other co-owners sued Tenneco Oil, claiming, among other things, that the two stock sales breached their first-refusal right.[105] Citing *Galveston Terminals, Inc. v. Tenneco Oil Co.*,[106] the co-owners argued that the court was required to view the three transactions together in determining

[103] *Id.* at 642.

[104] *Id.*

[105] The co-owners did not claim that Tenneco Oil's conveyance of its interest in the plant to Tenneco Natural Gas Liquids breached the first-refusal right because the right expressly exempted transfers to affiliates from its scope. *Id*. at 642.

[106] 904 S.W.2d 787 (Tex. App.—Houston [1st Dist.] 1995), *set aside without reference to the merits*, 922 S.W.2d 549 (Tex. 1996). In *Galveston Terminals*, Galveston Terminals' predecessor sold certain land to Tenneco Oil Company. The sales contract granted Galveston Terminals a first-refusal right on the tract if Tenneco "elect[ed] to sell all or any part of [it] . . . ." *Id.* at 788. Thereafter, Tenneco transferred thousands of acres of land to a newly formed subsidiary, including the tract burdened by the first-refusal right, and sold all of the subsidiary's stock to Fina Oil & Chemical Company, which dissolved the subsidiary and distributed the subsidiary's assets to itself. *Id.* at 789–90.

After learning about the transactions, Galveston Terminals sued Tenneco and Fina for breach of its first-refusal right, claiming that the substance of the transaction constituted a "sale" within the right's meaning. *Id.* at 789. In reversing a summary judgment in Tenneco's and Fina's favor, the First Court of Appeals was willing to review the transaction's "substance over form," holding that a fact issue existed with respect to Galveston Terminals' re-characterization of the three-step transaction as a sale of the burdened property:

> The character of a legal transaction depends on the intent and purpose of the parties. A contract regarding real property is construed as a whole. The courts will look to each and all of the parts of the written instrument, as well as to surrounding circumstances, to determine the intent and purpose of the parties. In order to ascertain the intention of the parties, all of the instruments that are shown to be component parts of a single transaction should be read together.
>
> Defendants argue that, viewed in isolation, none of the three transactions involved here constitutes a "sale." However, the summary judgment evidence viewed as a whole presents a picture of a transaction that, in a roundabout way, accomplished just what a direct sale would have . . . .

Id. at 791.

whether Tenneco Oil's interest in the plant had been "sold" in violation of the right.[107]

The Texas Supreme Court, in rejecting the holder's argument, "expressly disapproved" of *Galveston Terminals*:

> Sound corporate jurisprudence requires that courts narrowly construe rights of first refusal and other provisions that effectively restrict the free transfer of stock. Viewing several separate transactions as a single transaction to invoke the right of first refusal compromises the law's unfavorable estimation of such restrictive provisions.
>
> Moreover, the plain language of the Restated Operating Agreement provides that only a transfer of an ownership interest triggers the preferential right to purchase; it says nothing about a change in stockholders. The [holders] could have included a change-of-control provision in the agreements that would trigger the preferential right to purchase. None of the agreements among the parties contained such a provision. We have long held that courts will not rewrite agreements to insert provisions parties could have included or to imply restraints for which they have not bargained.
>
> In holding that the sale of a corporation's stock does not trigger rights of first refusal, we join courts from other jurisdictions that have considered this issue. We also recognize the insight of commentators who have long maintained that stock sales do not invoke preemptive rights. A contrary conclusion is an unwarranted impingement on the free transfer of stock.[108]

[107] *Tenneco*, 925 S.W.2d at 645 (noting that the co-owners argued that the court "should look to the parties' intent to determine the nature of the transaction").

[108] *Id.* at 646 (citations omitted); *accord* Cruising World, Inc. v. Westermeyer, 351 So. 2d 371, 373 (Fla. Dist. Ct. App. 1977); K.C.S., Ltd. v. E. Main St. Land Dev. Corp., 388 A.2d 181, 183 (Md. Ct. Spec. App. 1978); LaRose Mkt., Inc. v. Sylvan Ctr., Inc., 530 N.W.2d 505, 508 (Mich. Ct. App. 1995); Torrey Delivery, Inc. v. Chautauqua Truck Sales & Serv., Inc., 366 N.Y.S.2d 506, 510 (App. Div. 1975); Albright, *supra* note 19, at 811–12; Conine, *supra* note 19, at 1320 & n.231; Reasoner, *supra* note 19, at 72. *But see* Williams Gas Processing-Wamsutter

The grantor-corporation's merger into another corporation also usually does not trigger a first-refusal right because, like transfers between a corporation and its shareholder(s) or corporate affiliates, the property technically has not been sold, conveyed, or transferred.[109]

4. The Burdened Property's Inclusion in a Multi-Property Package or in the Sale of a Larger Property

In Texas, a third party's bona fide offer to purchase property burdened by a first-refusal right as part of either a package deal involving multiple properties or the sale of a larger property triggers the right irrespective of whether the grantor and third party apportion the purchase price between the burdened and unburdened properties.[110] The rationale for this rule is

Co. v. Union Pac. Res. Co., 25 P.3d 1064, 1073 (Wyo. 2001) (refusing to follow *Tenneco*).

Of course, *Tenneco's* holding seems to provide grantors with an avoidance technique. That is, they can transfer the burdened property to a wholly-owned subsidiary and then sell the subsidiary's stock to a third party without triggering the right. And, it appears, based on *Tenneco's* express disapproval of *Galveston Terminals'* reasoning and its holding that first-refusal rights should be narrowly construed, that, in Texas, a grantor can create a new subsidiary for purposes of such a transaction. *Tenneco*, 925 S.W.2d at 646.

[109] *E.g.*, Engel v. Teleprompter Corp., 703 F.2d 127, 134–35 (5th Cir. 1983) (applying Texas law).

[110] McMillan v. Dooley, 144 S.W.3d 159, 179 (Tex. App.—Eastland 2004, pet. denied) (holding that a first-refusal right was triggered by the burdened oil and gas lease's sale with two other leases); Comeaux v. Suderman, 93 S.W.3d 215, 221 n.3 (Tex. App.—Houston [14th District] 2002, no pet.) (holding that a first-refusal right was triggered by the burdened one acre tract's sale as part of a larger tract); Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 189 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.) (holding that a first-refusal right was triggered by a burdened condominium unit's sale with twenty-four other units); Foster v. Bullard, 496 S.W.2d 724, 736–37 (Tex. Civ. App.—Austin 1973, writ ref'd n.r.e.) (holding that a first-refusal right was triggered by the burdened forty-eight acre tract's sale as part of the sale of a 2487 acre ranch); *see* Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 535 (Tex. App.—Waco 2008, pet. denied) (holding that a first-refusal right was triggered by the burdened working interest's sale with stock in the grantor's parent corporation and the entry of a thirteen county, area of mutual interest agreement). Also noteworthy is *FWT, Inc. v. Haskin Wallace Mason Property Management, L.L.P.*, 301 S.W.3d 787 (Tex. App.—Fort Worth 2009, pet. filed), which involved the question of whether, in a multi-asset sale, the holder has to purchase both the burdened property and other assets. There, the court assumed that the offer triggered the right because the holder abandoned its summary judgment argument that the right had not been triggered. *Id.* at 794 n.4.

Some courts from other jurisdictions follow the Texas rule. *See, e.g.*, Anderson v. Armour & Co., 473 P.2d 84, 89 (Kan. 1970); Berry-Inverson Co. of N.D., Inc. v. Johnson, 242 N.W.2d 126, 134 (N.D. 1976); Boyd & Mahoney v. Chevron U.S.A., 614 A.2d 1191, 1194 (Pa. Super. Ct.

that to hold otherwise would allow the grantor and a prospective third-party buyer to destroy the first-refusal right.[111] In such a situation, however, the holder can neither be compelled to purchase nor require the grantor to sell any property beyond that burdened by the first-refusal right.[112]

1992); Wilber Lime Prods., Inc. v. Ahrndt, 673 N.W.2d 339, 343 (Wis. Ct. App. 2003). *See generally* Daskal, *supra* note 1, at 480–84 (discussing cases)

Courts rejecting the Texas rule mostly hold that a third party's bona fide offer to purchase the burdened property as part of either a package deal involving multiple properties or a larger property does not trigger the first-refusal right because "an attempt to sell the whole may not be taken as a manifestation of an intention or desire on the part of the owner to sell the smaller optioned part . . . ." Chapman v. Mut. Life Ins. Co., 800 P.2d 1147, 1151 (Wyo. 1990); *accord* Gyurkey v. Babler, 651 P.2d 928, 933 (Idaho 1982); Guaclides v. Kruse, 170 A.2d 488, 493 (N.J. Super. Ct. App. Div. 1961); Daskal, *supra* note 1, at 475–77. These courts, however, will enjoin the grantor from including the burdened property in the transaction or, if the sale has been consummated, order a purchaser with notice of the first-refusal right to re-convey the burdened property to the grantor. In either event, the court also will enjoin the grantor from selling the burdened property until after it receives an offer for only the burdened property and complies with the right. *E.g.*, *Chapman*, 800 P.2d at 1152; *Gyurkey*, 651 P.2d at 934; Daskal, *supra* note 1, at 475–76.

[111] *Navasota Res.*, 249 S.W.3d at 534; *Comeaux*, 93 S.W.3d at 221 n.3; *see Riley*, 808 S.W.2d at 189.

[112] Pantry Pride Enters., Inc. v. Stop & Shop, Cos., 806 F.2d 1227, 1229 (4th Cir. 1986) (applying Virginia law) ("Every court to consider the matter has held that a [grantor] cannot force an option holder to buy more property than that covered by the first-refusal provision."); *Navasota Res.*, 249 S.W.3d at 537 (holding that the holder of a first-refusal right on an oil and gas interest was not required to purchase the interest and stock in the grantor's parent or to enter into a thirteen county area of mutual interest agreement); *McMillan*, 144 S.W.3d at 179 (concluding that the holder of a first-refusal right on an oil and gas lease was not required to purchase two other oil and gas leases); *Comeaux*, 93 S.W.3d at 221 n.3 (holding that the holder of a first-refusal right on a one acre tract was not required to purchase adjoining land); Hinds v. Madison, 424 S.W.2d 61, 64 (Tex. Civ. App.—San Antonio 1967, writ ref'd n.r.e.) ("We do not see how in any way [the holder's] option or preference right to purchase a portion of the property sought to be sold can be enlarged to cover other lands owned by lessors, or can in any manner cover anything except the property actually subject to the [first-refusal right]."); Daskal, *supra* note 1, at 480 ("[A]mong the courts that conclude the right of first refusal is activated by a package deal, most hold that the rightholder is entitled to specific performance on the burdened property alone."). *But see*, *FWT, Inc.*, 301 S.W.3d at 801–03.

In *FWT, Inc. v. Haskin Wallace Mason Property Management, L.L.P.*, Haskin Wallace purchased certain real property (the Property) from FWT for the construction of a galvanizing facility. *Id.* at 789. The deed gave FWT a first-refusal right on the Property, if Haskin Wallace sold it. *Id.* at 789–90. Haskin Wallace created U.S. Galvanizing, L.P., to operate the galvanizing facility, and the facility was built on the Property. *Id.* at 790.

Haskin Wallace eventually entered into a contract selling the assets of U.S. Galvanizing and another galvanizing business to Valmont for $16,500,000, leasing the Property to Valmont for

$25,000 per month for five years with two additional five-year options, and giving Valmont an option to purchase the Property for $2,500,000, subject to FWT's first-refusal right. *Id.* Pursuant to the right, Haskin Wallace sent FWT a letter notifying it of the agreement and advising it that Valmont's "purchase of one 'bundle of assets is contingent upon the purchase of another.'" *Id.* FWT purported to exercise the right, but only as to the Property. *Id.* at 790–91. Haskin Wallace then sued for a declaratory judgment that FWT waived its right by failing to exercise it with respect to both the Property and the galvanizing companies' assets. *Id.* at 791.

On appeal, the Second Court of Appeals rejected FWT's argument that a grantor cannot condition the holder's ability to exercise a first-refusal right on the purchase of assets in addition to the burdened property. *Id.* at 793. In doing so, it distinguished or found inapposite five Texas cases standing for the proposition that a holder cannot be compelled to purchase, or require the grantor to sell, any property other than the burdened property: *Navasota*, *McMillan*, *Comeaux*, *Riley*, and *Hinds*. *Id.* at 794–99. Rather, citing *West Texas Transmission L.P. v. Enron Corp.*, 907 F.2d 1554 (5th Cir. 1990), and its Texas progeny, *Shell v. Austin Rehearsal Complex, Inc.*, No. 03-97-00411-CV, 1998 WL 476728 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication), and *Texas State Optical, Inc. v. Wiggins*, 882 S.W.2d 8 (Tex. App.—Houston [1st Dist.] 1994, no writ), the court held that, because Valmont's offer on the property was conditioned on the purchase of the galvanizing companies' assets, FWT had to comply with that condition unless it was commercially unreasonable or imposed in bad faith to defeat FWT's first-refusal right:

> The language in the Deed also supports our decision to follow the *West Texas Transmission* line of cases. The Deed gives FWT a preferential right to purchase the Property at the same price and "under the same terms and conditions offered by the prospective purchaser," Valmont. Valmont conditioned its purchase or lease of the Property on its acquisition of the assets of the galvanizing businesses. FWT accepted the risk that it is now confronted with in this case because it agreed to language in the Deed allowing a third party to dictate the terms and conditions under which it would purchase or lease the Property. Applying *Hinds*, *McMillan*, and *Navasota* would effectively circumvent the parties' intent as expressed in the Deed.
>
> FWT's argument that the parties could simply bundle burdened property with other assets to evade a preferential right is untenable in light of the three inquiries identified in *West Texas Transmission*. The *West Texas Transmission* line of cases affords a factfinder opportunity to make certain inquiries regarding the terms and conditions of a contract offered by a bona fide purchase (i.e., commercial reasonableness, bad faith, designed to defeat preferential right) when the preferential rightholder's decision to exercise its right is not unequivocal. These inquiries can protect the interests of both parties, as demonstrated in *West Texas Transmission* (the rightholder had to accept the challenged condition) and *[Texas State Optical*] (the rightholder did not have to accept the challenged conditions).
>
> This flexibility is particularly important in this case. When Haskin Wallace purchased the Property, it was undeveloped. Thereafter a multi-million dollar galvanizing business was constructed directly on the Property . . . . The commercial reasonableness and good faith regarding the challenged terms and conditions of

> Valmont's offer to Haskin Wallace are relevant considerations in light of the extensive improvements made to the Property. This is so because, absent an agreement to the contrary between U.S. Galvanizing and Haskin Wallace, U.S. Galvanizing's structures on the Property are likely fixtures. And FWT's claimed option to purchase the Property for $2.5 million does not include the value of the structures affixed to the Property. Thus, theoretically, applying the *Hinds* line of cases—which would allow FWT to purchase the Property for $2.5 million without also purchasing the assets of U.S. Galvanizing—could give FWT an ownership claim to the structures on the Property even though it did not pay for them. Applying *Hinds*, *McMillan*, and *Navasota* would not permit an inquiry into the considerations outlined in *West Texas Transmission*.

FWT, Inc. v. Haskin Wallace Prop. Mgmt., L.L.P., No. 2-08-321-CV, 2009 Tex. App. LEXIS 6953, at *37–40 (Tex. App.—Fort Worth Aug. 27, 2009) (citations omitted), *withdrawn*, 301 S.W.3d 787 (Tex. App.—Fort Worth 2009, pet. filed). Because no evidence existed that the condition to purchase the galvanizing businesses' assets was commercially unreasonable or imposed in bad faith to defeat FWT's first-refusal right, the court concluded that FWT waived its preferential right by not offering to purchase the galvanizing businesses' assets. *Id.* at *40.

The reasoning in *FWT* is questionable for a number of reasons. At the outset, it is contrary to the overwhelming majority of cases from both Texas and other jurisdictions that hold that a holder can neither be required to purchase nor require the grantor to sell any property besides the burdened property when it is sold as part of a package of other properties or a larger property. In fact, other cases involving comparable situations have concluded that the first-refusal right does not apply to personal property sold with the burdened property. *E.g.*, *Pantry Pride Enters.*, 806 F.2d at 1229 (holding that lessor's first-refusal right extended only to leasehold and not to the lessee's equipment); *see Navasota Res.*, 249 S.W.3d at 537 (holding that the holder of a first-refusal right on an oil and gas interest was not required to purchase the interest and stock in the grantor's parent and to enter into a thirteen county area of mutual interest agreement); *see also* Holston Invests., Inc. B.V.I. v. Lanlogistics, Corp., No. 08-21569-CIV-MORENO, 2009 U.S. Dist. LEXIS 85419, at *10–11 (S.D. Fla. Sept. 18, 2009) (applying Florida law) (holding that sale of two other companies with the burdened company triggered first-refusal right only as to the burdened company); Radio Webs, Inc. v. Tele-Media Corp., 292 S.E.2d 712, 715 (Ga. 1982) (rejecting grantor's argument that holder should be required to purchase a second cable television station and other assets packaged with the cable television station burdened by the first-refusal right because it was economically infeasible to sell the two stations separately); Ollie v. Rainbolt, 669 P.2d 275, 281 (Okla. 1983) (rejecting grantor's argument that holder should be required to purchase both corporate stock burdened by first-refusal right and other stock).

Moreover, *FWT's* reliance on *West Texas Transmission* and its progeny is misplaced for two reasons. First, *West Texas Transmission* involved the sale of a single asset, a pipeline, rather than the sale of a package of assets. *See W. Tex. Transmission*, 907 F.2d at 1556–59. Second, as discussed in detail below, it is questionable whether *West Texas Transmission's* bad-faith requirement is consistent with Texas law. *See infra* Part V.B.

Finally, the decision appears to be one of a "hard case making bad law" because it clearly reflects the Second Court of Appeals' concern that FWT would receive a windfall if it were allowed to purchase only the Property. *FWT, Inc.*, 2009 Tex. App. LEXIS 6953, at *40. This concern, however, was wholly unwarranted because it is tantamount to a rewriting of the first-

5. The Burdened Property's Transfers Between Co-owners

Texas courts, like the courts from most other jurisdictions, hold that, absent language to the contrary in the first-refusal right, a co-owner's sale of its interest in the burdened property to another co-owner does not trigger the right because the right's purpose is to prevent the entry of outsiders.[113]

IV. WHAT NOTICE MUST BE GIVEN TO THE HOLDER?

Most first-refusal rights require the grantor to give a specific notice of the third party's bona fide offer to the holder promptly.[114] The following

refusal right. When it purchased the Property, Haskin Wallace planned to construct a galvanizing facility on it. *Id.* at *3. Thus, it could have insisted that the first-refusal right require FWT to purchase both the Property and the galvanizing business' assets, if they were sold together. The court's reasoning also ignores the fact that, in selling the galvanizing businesses, FWT could have structured the transaction to prevent an inequitable result by, for example, allocating a fair value to the Property and conditioning its sale on a long term or perpetual lease to Valmont.

[113] *E.g.*, Bill Signs Trucking, L.L.C. v. Signs Family Ltd. P'ship, 69 Cal. Rptr. 3d 589, 598–99 (Ct. App. 2007) (holding that tenant's first-refusal right under a commercial lease was not triggered by the conveyance of an interest in the property between the co-partners in a family limited partnership that owned the property and that was the landlord); Pellandini v. Valadao, 7 Cal Rptr. 3d 413, 417–18 (Ct. App. 2003) (concluding that the burdened property's sale between co-owners did not trigger first-refusal right); Byron Material, Inc. v. Ashelford, 339 N.E.2d 26, 29 (Ill. App. Ct. 1975) (holding that sale of an interest in leased property from one co-tenant to another did not trigger first-refusal right); Rucker Props., L.L.C. v. Friday, 204 P.3d 671, 676 (Kan. Ct. App. 2009) ("[B]ecause the conveyance . . . was an intra-family gift and not a sale and no ownership was transferred to anyone outside of the lease agreement, the right of first refusal was not triggered."); Wilson v. Grey, 560 S.W.2d 561, 562 (Ky. 1978) (concluding that sale from one lessor to another did not trigger the lease's first-refusal right); Rogers v. Neiman, 193 N.W.2d 266, 267 (Neb. 1971) ("We think the proper construction of the lease was that an option existed only if the entire property was offered for sale by all of the lessors."); Baker v. McCarthy, 443 A.2d 138, 141 (N.H. 1982) ("The reference to the grantors in the plural, in our opinion, clearly contemplates that an offer to purchase would be made by a third party to the grantors as a whole group." (emphasis omitted)); Koella v. McHargue, 976 S.W.2d 658, 660 (Tenn. Ct. App. 1998) ("Our conclusion that the transfer between co-tenants did not trigger a right of first refusal protects defendants' rights against third-party purchases."); Tex. Co. v. Graf, 221 S.W.2d 865, 866 (Tex. Civ. App.—Fort Worth 1949, writ ref'd n.r.e.) (holding that a tenant in common's transfer of his interest in the burdened property to another tenant in common did not trigger the plaintiff tenant in common's first-refusal right).

[114] A question exists regarding whether the typical first-refusal right, which is triggered by the receipt of an acceptable bona fide offer, is breached if the grantor enters into a contract with a third party conditioned on the holder's waiver of the right. Although one leading commentator on contract law maintains that a breach occurs, no reason exists why such a conditional contract should violate the first-refusal right. *Compare* CORBIN, *supra* note 1, § 11.3, at 480, *with*

questions arise with respect to notice: (1) What information must the notice contain when the right is silent as to its requirements and what is the holder's duty if the notice is ambiguous or unclear?; (2) If the right specifically sets forth the notice's requirements, is the holder excused from exercising the right if the notice does not comport exactly with the right's terms?; and (3) What happens to the right if the holder is given no or insufficient notice?

A. The Grantor's and Holder's Obligations when the First-Refusal Right Does Not Specify the Notice's Requirements

When the first-refusal right is silent regarding the notice's requirements, most courts, including Texas courts, hold that any method that gives the holder notice of the potential sale and that reasonably discloses the sales' terms and conditions is sufficient to trigger the right.[115] Disclosure is reasonable if the notice provides the holder with sufficient information to make an informed decision about exercising the right.[116]

Although the case law does not specify what constitutes sufficient information, clearly all of the offer's material terms and conditions must be disclosed.[117] Of course, the provision of a copy of the proposed purchase

Cipriano v. Glen Cove Lodge No. 1458, B.P.O.E., 801 N.E.2d 388, 393 n.3 (N.Y. 2003).

[115] *E.g.*, Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1212 (5th Cir. 1990) (applying Texas law); *accord* Roeland v. Trucano, 214 P.3d 343, 348 (Alaska 2009); Dyrdal v. Golden Nuggets, Inc., 672 N.W.2d 578, 584–85 (Minn. Ct. App. 2003); McMillan v. Dooley, 144 S.W.3d 159, 174, 177–78 (Tex. App.—Eastland 2004, pet. denied); John D. Stump & Assocs., Inc. v. Cunningham Mem'l Park, Inc., 419 S.E.2d 699, 706 (W. Va. 1992).

[116] *See Koch Indus.*, 918 F.2d at 1212; *Roeland*, 214 P.3d at 348; Union Oil Co. of Cal. v. Mobil Pipeline Co., No. Civ.A.19395-N, 2006 WL 3770834, at *15 (Del. Ch. Dec. 15, 2006); *Drydal*, 672 N.W.2d at 585; *John D. Stump & Assocs.*, 419 S.E.2d at 706. *But see* Gyurkey v. Babler, 651 P.2d 928, 931 (Idaho 1982) (holding that the holder cannot be called upon to exercise or lose first-refusal right "unless the entire offer is communicated to him in such a form as to enable him to evaluate it and make a decision" (emphasis omitted)); Hancock v. Dusenberry, 715 P.2d 360, 364–65 (Idaho Ct. App. 1986) (applying *Gyurkey*).

[117] *Roeland*, 214 P.3d at 348 n.11 ("[A]ll terms and entire offer must be communicated but copy of offer ordinarily sufficient so long as it contains full agreement between seller and third party."); Jordahl v. Concordia Coll., No. C1-97-825, 1998 WL 2411, at *3 (Minn. Ct. App. Jan. 6, 1998) (rejecting holder's complaint that there was improper notice because the notice only provided the third-party offer's essential terms); *see* Briggs v. Sylvestri, 714 A.2d 56, 59–60 (Conn. App. Ct. 1998) ("A letter of notice to the holder, which sets out the terms of the proposed transaction, is all that is required."); *Union Oil Co.*, 2006 WL 3770834, at *14–15 (holding that holder need not match undisclosed price terms).

agreement or third-party offer provides reasonable notice.[118] Once the grantor reasonably discloses the terms of the third party's bona fide offer, the holder "has a subsequent duty to undertake a 'reasonable' investigation of any terms unclear to him."[119]

Thus, when the first-refusal right does not specify the notice's terms and the notice is ambiguous or unclear, the burden is on the holder to seek clarification.[120] The holder only meets its burden by formally requesting clarification, and not by mere objection to the notice.[121] "Once such request is made, the owner must respond or assume the burden of showing that the notice was reasonably accurate."[122] If the holder does not request clarification and rejects the offer, it may not contest the notice's reasonableness later.[123]

B. Substantial Performance of the Notice's Requirements Is Sufficient

When the first-refusal right specifically sets forth the notice's requirements, the holder is not excused from exercising the right if the notice fails to comport exactly with the right's terms.[124] Substantial

[118] *Koch Indus.*, 918 F.2d at 1212–13; *McMillan*, 144 S.W.3d at 177–78; *Roeland*, 214 P.3d at 348 & n.11; *Dyrdal*, 672 N.W.2d at 584; Matson v. Emory, 676 P.2d 1029, 1033 (Wash. Ct. App. 1984); *see* Eliminator, Inc. v. 4700 Holly Corp., 681 P.2d 536, 539 (Colo. Ct. App. 1984); Smith v. Hervo Realty Corp., 507 A.2d 980, 985–86 (Conn. 1986).

[119] *Koch Indus.*, 918 F.2d at 1212; *accord Roeland*, 214 P.3d at 349; *McMillan*, 144 S.W.3d at 177–82; *Drydal*, 672 N.W.2d at 585; *John D. Stump & Assocs.*, 419 S.E.2d at 706; *see Jordahl*, 1998 WL 2411, at *3 (rejecting holder's complaint that there was improper notice because the notice provided the third party offer's essential terms).

[120] *See Jordahl*, 1998 WL 2411, at *3.

[121] *E.g.*, *Koch Indus.*, 918 F.2d at 1212–14 (holding that the holder must actually and formally seek clarification of any ambiguous terms in the third-party offer, and not merely object to the notice); Comeaux v. Suderman, 93 S.W.3d 215, 222–23 (Tex. App.—Houston [14th Dist.] 2002, no pet.) (same); *see Eliminator*, 681 P.2d at 539 (holding that the holder's failure to inquire further about the third-party offer, not defective notice, was the cause of the holder's inability to exercise its first-refusal right). *But see Roeland*, 214 P.3d at 349 ("A right holder may fulfill this duty to investigate by asking about the specific unclear issues, seeking additional information, or advising the seller that the right holder considers the notice insufficient, vague, or ambiguous.").

[122] *John D. Stump & Assocs.*, 419 S.E.2d at 706; *accord Koch Indus.*, 918 F.2d at 1212.

[123] *See Koch Indus.*, 918 F.2d at 1212; *Drydal*, 672 N.W.2d at 585–86; *McMillan*, 144 S.W.3d at 177–82; *Comeaux*, 93 S.W.3d at 222–23; *John D. Stump & Assocs.*, 419 S.E.3d at 706.

[124] *E.g.*, *Comeaux*, 93 S.W.3d at 221.

performance by the grantor of the notice's requirements is sufficient to require action by the holder.[125] In other words, "perfect" notice is not required because the notice is merely incidental to the first-refusal right—the primary right afforded the holder is the right to purchase on the third party's terms.

Comeaux v. Suderman[126] illustrates this principle. In that case, a lease granted the lessee a first-refusal right on the leased premises, a one-acre tract used for a public fishing pier.[127] The first-refusal right required the lessor to "notify Lessee in writing of the true and complete terms and conditions of any proposed sale to a third party at least ninety (90) days prior to the date of closing of such proposed sale . . . ."[128]

The lessor eventually notified the lessee in writing of a pending $350,000 cash offer for the leased premises and some adjoining property.[129] The notice did not advise the lessee that the total acreage covered by the offer was thirty-five acres, did not provide the offer's other terms, and did not provide a copy of the third party's earnest money contract.[130]

The lessee initially advised the grantor that he would not exercise his

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[125] *E.g.*, *Jordahl*, 1998 WL 2411, at *3 (rejecting holder's complaint that improper notice existed due to an ambiguity in the purchase agreement's price terms because the holder received the essential terms and that was sufficient); Ellis v. Waldrop, 656 S.W.2d 902, 904 (Tex. 1983) (affirming a jury finding that the grantor substantially performed a first-refusal right's notice requirements and that the holder had waived its preferential right by failing to exercise it within the stated period); Durrett Dev., Inc. v. Gulf Coast Concrete, LLC, No. 14-07-01062-CV, 2009 Tex. App. LEXIS 6787, at *14 n.2 (Tex. App.—Houston [14th Dist.] Aug. 27, 2009, no. pet. h.) ("In the notice, the [grantor] made a reasonable disclosure of the terms of the proposed sale to [the third party] and of [the grantor's] willingness to accept the terms."); Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd., 225 S.W.3d 577, 591 (Tex. App.—El Paso 2005, pet. denied) ("The notice given was sufficient to reasonably disclose the proposed transaction and to provide Fasken entities an opportunity to exercise its preferential right . . . even if there were technical deficiencies that rendered that notice less than perfect."); *Comeaux*, 93 S.W.3d at 221 ("We find that Suderman's notice to Comeaux, while not a model of clarity, reasonably disclosed Suderman's intention to sell the leased premises and additional property to a third party for a total price of $350,000."); Mecom v. Gallagher, 213 S.W.2d 304, 310–11 (Tex. Civ. App.—El Paso 1947, no writ) (opinion on rehearing) (holding that the notice's failure to comply with the first-refusal right's requirements was not a breach of the right because the holder discussed the third party's offer for the burdened property with both the grantors and their real-estate broker).

[126] 93 S.W.3d 215 (Tex. App.—Houston [14th Dist.] 2002, no pet.).

[127] *Id.* at 217.

[128] *Id.*

[129] *Id.*

[130] *Id.*

first-refusal right because he could not afford to pay the $350,000 purchase price.[131] After the lessor sold the property to the third party, the lessee sued the lessor for the first-refusal right's breach, claiming that the right was never triggered because the notice neither offered him the opportunity to purchase only the leased premises nor provided all the terms and conditions of the third party's earnest money contract as required by the first-refusal right.[132]

In affirming the trial court's summary judgment in the lessor's favor, the Fourteenth Court of Appeals rejected the lessee's argument that he was not required to do anything until he received the purchase offer's complete terms.[133] Instead, the court held that the right terminates, if after receiving reasonable notice of the offer, the holder does not seek clarification of unclear terms and does nothing to exercise the right:

> Here, [the lessor] prepared written notice to [the lessee] informing him of a pending sale of the leased premises and adjoining property for $350,000. [The lessor] also reminded [the lessee] of his right of first refusal, and invited him to contact either [the lessor] or [his] real-estate agent[] to discuss the matter further.
>
> We find that [the lessor's] notice to [the lessee], while not a model of clarity, reasonably disclosed [the lessor's] intention to sell the leased premises and additional property to a third party for the total price of $350,000. When an owner makes a reasonable disclosure of the terms of a proposed sale to another, the holder of the right of first refusal has a duty to undertake a reasonable investigation of any terms unclear to him. A right holder who fails to do so cannot subsequently complain that he lacked sufficient information to make an informed choice about whether to purchase the property that is subject to the right of first refusal.[134]

[131] *Id.* at 218.

[132] *Id.* at 221.

[133] *Id.* at 222.

[134] *Id.* at 221; *accord* Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1212 (5th Cir. 1990); Drydal v. Golden Nuggets, Inc., 672 N.W.2d 578, 585–86 (Minn. Ct. App. 2003); Durrett Dev., Inc. v. Gulf Coast Concrete, LLC, No. 14-07-01062-CV, 2009 Tex. App. LEXIS 6787, at *13 n.2

When the first-refusal right specifies the notice's requirements, the grantor need not provide the holder with additional information. For example, in *Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd.*,[135] a "Unit Operating Agreement" for certain Permian Basin oil and gas properties (the Midland Farms Unit) contained a first-refusal right requiring each party, if it decided to sell its interest in the unit, to provide the other parties with a notice containing certain elements:

> (1) [T]he name and address of the prospective purchaser . . . (2) the purchase price or in the event of a transfer . . . of a group of properties, an allocation of the purchase price attributable to its interest in the oil and gas estate under this Agreement or in the Unit Area; (3) a legal description sufficient to identify the property and interest; and (4) all other terms of the proposed sale . . . ."[136]

Thereafter, one of the parties to the operating agreement, Altura, decided to sell all of its Permian Basin oil and gas properties through a bidding process.[137] The winning bidder, OPC, assigned a $63,000,000 value to the party's interest in the Midland Farm Unit, and Altura notified the other parties to the operating agreement, the Fasken entities, that they could purchase its interest in the unit for that amount under the first-refusal right.[138] The Fasken entities then requested Altura to provide "all documents and other information necessary to verify the basis for the $63,000,000 allocation" and stated that until they received all of the information that Altura was required to provide they would "not consider the fifteen (15) day notice period to have commenced."[139]

After Altura refused to provide the allocation information, the Fasken

(Tex. App.—Houston [14th Dist.] Aug. 27, 2009, no. pet. h.); McMillan v. Dooley, 144 S.W.3d 159, 177–82 (Tex. App.—Eastland 2004, pet. denied); John D. Stump & Assocs., Inc. v. Cunningham Mem'l Park, Inc., 419 S.E.2d 699, 706 (W. Va. 1992).

Significantly, in *Comeaux*, the burdened property was sold as part of a larger property and the holder was offered the opportunity to purchase only the larger property, and not just the burdened property. Despite this fact, the court placed the burden on the holder to insist on his right to purchase only the burdened property. *Comeaux*, 93 S.W.3d at 222–23; *accord McMillan*, 144 S.W.3d at 177–82.

[135] *Id.* at 577.

[136] *Id.* at 589–90.

[137] *Id.* at 582.

[138] *Id.* at 583–84.

[139] *Id.* at 585.

entities sued, seeking a declaration that Altura's notice was deficient because it did not provide the allocation information.[140] The Eighth Court of Appeals rejected the argument because "no such information was required by [the first-refusal right] for purposes of providing notice of the proposed transaction."[141]

C. No or Insufficient Notice

A first-refusal right is not triggered if the grantor fails to give notice or gives insufficient notice.[142] As held by the Eleventh Court of Appeals, "[t]he rightholder does not have a duty to act in order to exercise his preferential purchase right unless and until he receives a reasonable disclosure of the terms of the contemplated conveyance."[143] Additionally, the grantor cannot rely on the holder's constructive notice.[144] However, once the holder learns about a transaction in violation of its first-refusal right, it has a duty to act if it wants to acquire the property from a third party who purchased the burdened property with notice of the first-refusal right.[145]

However, how much time the holder has to act is unclear. A few Texas cases, in dicta, suggest that that the holder, upon learning of a sale in violation of its first-refusal right, must act within the time period specified in the right, that is, if the right gives the holder ten days after notice to accept or reject the third party's bona fide offer, the holder must act within that period.[146] Other cases, however, hold that the holder must act within a

[140] *Id.* at 586, 589–90.

[141] *Id.* at 590.

[142] McMillan v. Dooley, 144 S.W.3d 159, 174 (Tex. App.—Eastland 2004, pet. denied).

[143] *Id.*; *accord* Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1212 (5th Cir. 1990). Atchison v. City of Englewood, 568 P.2d 13, 20 (Colo. 1977); Foster v. Bullard, 496 S.W.2d 724, 736–37 (Tex. Civ. App.—Amarillo 1973, writ ref'd n.r.e.).

[144] Mandell v. Mandell, 214 S.W.3d 682, 688 (Tex. App.—Houston [14th Dist.] 2007, no pet.) (rejecting grantor's argument that the holder's knowledge about a contingent-fee contract giving the grantor's attorney a percentage of any recovery in a lawsuit against the holder was notice that the burdened property would be transferred to the attorney in satisfaction of the contingent-fee contract); *Atchison*, 568 P.2d at 20 (rejecting argument that the holder's claim was barred because he should have read newspaper accounts about the burdened property's sale).

[145] *See Koch Indus.*, 918 F.2d at 1212; *Mandell*, 214 S.W.2d at 688; *McMillan*, 144 S.W.3d at 174; A.G.E., Inc. v. Buford, 105 S.W.3d 667, 673 (Tex. App.—Austin 2003, pet. denied); Sanchez v. Dickinson, 551 S.W.2d 481, 485 (Tex. Civ. App.—San Antonio 1977, no writ); Martin v. Lott, 482 S.W.2d 917, 922–23 (Tex. Civ. App.—Dallas 1972, no writ).

[146] *McMillan*, 144 S.W.3d at 173; *A.G.E., Inc.*, 105 S.W.3d at 673.

reasonable time after the holder learns about the property's sale in violation of the first-refusal right.[147] Neither set of cases, however, appears to be correct because they are inconsistent with the general rule that, absent waiver, estoppel, or laches, a non-breaching party has four years to bring an action for specific performance after a contract's breach.[148]

V. EXERCISING THE FIRST-REFUSAL RIGHT

Typically, a first-refusal right provides that the holder must exercise it by agreeing to all the "terms and conditions" of a third party's bona fide offer.[149] Questions arise, however, regarding how long the holder has to exercise the right and when acceptance occurs. In addition, disputes often arise when: (1) the holder insists that the grantor vary the third party's offer to fit the holder's situation; (2) the offer involves unique consideration that is impossible for the holder to match; (3) the holder's security, financing, or guarantees are less secure, valuable or certain than the third party's; (4) the right's exercise will impose an adverse tax burden on the grantor; (5) the grantor insists that the holder match the price allocated to the burdened property by a third party when the property is sold as part of package deal involving multiple properties or the sale of a larger property; or (6) the contract contains a "dual option," that is, a fixed-price option and a first-

[147] *Koch Indus.*, 918 F.2d at 1212; *Martin*, 482 S.W.2d at 921.

[148] *See infra* note 337.

[149] *See supra* note 55. On occasion, a first-refusal right will only require the holder to match the price offered by the third party. *E.g.*, Kroehnke v. Zimmerman, 467 P.2d 265, 266 (Colo. 1970); Union Oil Co. of Cal. v. Mobil Pipeline Co., No. Civ.A.19395-N, 2006 WL 3770834, at *3 (Del. Ch. Dec. 15, 2006); Estate of Lien v. Pete Lien & Sons, Inc., 740 N.W.2d 115, 120 (S.D. 2007). In such cases, an obvious question arises regarding what constitutes the price, if the transaction is not an all cash one. Courts have considered this question:

> While "price" obviously includes an amount of money, the common and ordinary meaning of "price" does not exclude non-monetary forms of consideration. "Price" is defined in BLACK'S LAW DICTIONARY 1207 (7th ed. 1999) as "[t]he amount of money *or other consideration* asked for or given in an exchange for something else; the cost at which something is bought or sold."

McMillan v. Dooley, 144 S.W.3d 159, 176 (Tex. App.—Eastland 2004, pet. denied) (emphasis in original); *accord Union Oil Co. of Cal.*, 2006 WL 3770834, at *13 ("[T]he word 'price' does not simply mean 'cash.' 'Price' is essentially equivalent to 'consideration' and in the context of the [first-refusal right], it simply refers to all the material things that the seller will get in the deal—i.e., all of the consideration-related terms."); *Estate of Lien*, 740 N.W.2d at 120–21 (holding that the term "price" in a first-refusal right includes the cash paid and all non-monetary consideration).

refusal right, and the optionee/holder attempts to exercise the fixed-price option after receiving notice of a third-party offer for the burdened property. Each of these issues is explored below.

A. The Holder's Time to Accept and the Manner of Acceptance

Typically, the first-refusal right sets forth the time (usually a matter of days) that the holder has to exercise the right after receiving notice of the triggering offer. In such a case, the holder must exercise the right before the period expires.[150] If the right does not set forth how long the holder has to exercise it after receiving notice of the triggering offer, the holder has a reasonable time to exercise it.[151]

In the absence of an expression to the contrary in the first-refusal right or notice, the acceptance must be received to be effective.[152] That is, if the right gives the holder ten days to exercise it, the grantor must receive the acceptance within the ten-day period.[153] This is consistent with the general rule that "an acceptance of an option contract is not operative until received by the optionor."[154] Moreover, if the first-refusal right or notice specifies the mode of acceptance (for example, by signing and returning the notice letter) the holder's acceptance, like any offer, must be in that mode to create a binding contract with the grantor.[155]

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[150] *E.g.*, Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 525–27 (Tex. App.—Amarillo 1998, pet. denied); Matson v. Emory, 676 P.2d 1029, 1033 (Wash. Ct. App. 1984).

[151] *E.g.*, Steinberg v. Sachs, 837 So. 2d 503, 505–06 (Fla. Dist. Ct. App. 2003); IH Riverdale, L.L.C. v. McChesney Capital Partners, L.L.C., 633 S.E.2d 382, 386–87 (Ga. Ct. App. 2006); *but cf.* KMI Cont'l Offshore Prod. Co. v. ACF Petroleum Co., 746 S.W.2d 238, 244 (Tex. App.—Houston [1st Dist.] 1987, writ denied) (holding that when an option fails to impose a time limit on its exercise, it must be exercised within a reasonable time); Maupin v. Dunn, 678 S.W.2d 180, 183 (Tex. App.—Waco 1984, no writ) (same).

[152] Maloney v. Atlantique Condo. Complex Ass'n, 399 So. 2d 1111, 1114 (Fla. Dist. Ct. App. 1981).

[153] *E.g.*, Smith v. Hevro Realty Corp., 507 A.2d 980, 985 (Conn. 1986); *Maloney*, 399 So. 2d at 1113; Romain v. A. Howard Wholesale Co., 506 N.E.2d 1124, 1128 (Ind. Ct. App. 1987); Santos v. Dean, 982 P.2d 632, 635–36 (Wash. Ct. App. 1999); *see* CORBIN, *supra* note 1, § 11.8, at 527.

[154] RESTATEMENT (SECOND) OF CONTRACTS § 63(b) (1981); *accord Maloney*, 399 So. 2d at 1113; *Santos*, 982 P.2d at 635; *see* CORBIN, *supra* note 1, § 11.8, at 527.

[155] *E.g.*, *Abraham Inv.*, 968 S.W.2d at 525 (holding that where the notice required the holder to exercise its right by signing and returning the notice letter, an oral acceptance was insufficient); *see* CORBIN, *supra* note 1, § 11.8, at 518, 529 (noting that if an option contract requires a particular mode of acceptance, the optionee must give notice of the option's exercise in that

B. A Holder's Attempt to Vary the Triggering Offer's Terms

Because a first-refusal right ripens into an option when the triggering notice is given,[156] Texas cases almost uniformly hold that the holder's acceptance, like an optionee's acceptance, must match the triggering offer exactly except for nominal changes need to reflect the parties' identities.[157] In applying Texas law, The United States Court of Appeals for the Fifth Circuit explained this rule:

> Like the acceptance of any other offer, the exercise of an option, must be "unqualified, absolute, unconditional, unequivocal, unambiguous, positive, without reservation and according to the terms or conditions of the option." An unqualified acceptance guarantees that the [grantor] will receive the benefit of the bargain under which he agreed to relinquish his interests.
>
> Where an acceptance varies from the original offer, the [grantor] stands to lose his bargain. As a result, a purported acceptance which leaves the [grantor] "as well off" as a third-party offer, but which modifies, adds to or otherwise qualifies the terms of the offer, generally constitutes a rejection of the option and a counteroffer.[158]

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mode); 2 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 6.12, at 125–26 (2007) ("[T]he manner of acceptance may be specified in the offer, as a condition to acceptance, in which case it must be complied with in order for a contract to be formed.").

[156] *See supra* note 7.

[157] *E.g.*, Durrett Dev., Inc. v. Gulf Coast Concrete, LLC, No. 14-07-01062-CV, 2009 Tex. App. LEXIS 6787, at *12 (Tex. App.—Houston [14th Dist.] Aug. 27, 2009, no. pet. h.); FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., No. 2-08-321-CV, 2009 Tex. App. LEXIS 6953, at *14 (Tex. App.—Fort Worth 2009, pet. denied), *withdrawn*, 301 S.W.3d 787 (Tex. App.—Fort Worth 2009, pet. filed); Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 533 (Tex. App.—Waco 2008, pet. denied); City of Brownsville v. Golden Spread Elec. Coop., Inc., 192 S.W.3d 876, 880 (Tex. App.—Dallas 2006, pet. denied).

[158] W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1565 (5th Cir. 1990) (quoting Scott v. Vandor, 671 S.W.2d 79, 84 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.)); *accord City of Brownsville*, 192 S.W.3d at 880 ("The rightholder's exercise of the option must be positive, unconditional, and unequivocal. The rightholder must accept all the terms of the offer or the offer will be considered rejected. In the absence of an agreement otherwise, unequivocal acceptance of the terms of the offer is considered an exercise of the right to purchase." (citations omitted)); *Navasota Res.*, 249 S.W.3d at 533 (same); Tex. State Optical, Inc. v. Wiggins, 882 S.W.2d 8, 10–11 (Tex. App.—Houston [1st Dist.] 1994, no writ) ("The exercise of an option, like

Thus, where the first-refusal right requires the holder to match all the "terms and conditions" of the third party's bona fide offer, the holder generally is required to do just that—exactly match all the triggering offer's terms and conditions, and not only its price terms.[159] The "exact-match" requirement is founded on the basic rule of offer and acceptance that an offeree may not vary the offer's terms—that is, an acceptance must be the "mirror image" of the offer.[160]

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the acceptance of any other offer, must be positive and unequivocal. As a general rule, an acceptance of an offer must not change or qualify the terms of an offer, and if it does, the offer is rejected. With regard to an option, generally a purported acceptance containing a new demand, proposal, condition, or modification of the terms of the offer is not an acceptance, but a rejection." (citations omitted)).

[159] *W. Tex. Transmission*, 907 F.2d at 1564 (rejecting the holder's argument that the phrase "terms and conditions" only required it to match the price terms); *accord* Weisser v. Wal-Mart Real Estate Bus. Trust, No. 04-15, 2005 U.S. Dist. LEXIS 11185, at *18–24 (E.D. Ky. June 8, 2005) (holding that the holder's modification of the third-party offer's default provision and addition of environmental provision was not a proper exercise of first-refusal right); Smith v. Hevro Realty Corp., 507 A.2d 980, 985 (Conn. 1986) (holding that the holder's failure to pay earnest money when it purported to exercise the first-refusal right as required by the triggering offer was not a proper acceptance); USA Cable v. World Wrestling Fed'n. Entm't, Inc., 766 A.2d 462, 471, 474 (Del. 2000) (holding that the holder's failure to match forum-selection and cross-promotion provisions of the third party's offer was not a proper acceptance); Christian v. Edelin, 843 N.E.2d 1112, 1115 (Mass. App. Ct. 2006) (holding that the holder's acceptance, which was subject to a mortgage contingency, did not match the third party's all cash offer); Weber Meadow-View Corp. v. Wilde, 575 P.2d 1053, 1055 (Utah 1978) (holding that the holder's offer to pay $200,000 in cash plus any house of grantor's choosing worth $50,000 for burdened property or less did not match the third party's offer of $200,000 in cash plus a specific house); John D. Stump & Assocs., Inc. v. Cunningham Mem'l Park, Inc., 419 S.E.2d 699, 705 (W. Va. 1992) (concluding that the holder's purported acceptance that rejected a provision in the triggering offer providing for cash consideration for the grantor's covenant not to compete and that conditioned holder's acceptance on his ability to obtain financing was "not a clear and unequivocal acceptance of the [grantor's] offer to sell, and, therefore, as a matter of law, the [grantor] could reject his response").

[160] *E.g.*, 1 ARTHUR LITTON CORBIN, CORBIN ON CONTRACTS § 3.29, at 464 (Joseph M. Perillo ed., rev. ed. 1993) ("If the offeree changes any term [of the offer], the offeree is not accepting the offer. The offeror and the offeree, alike, must express agreement as to every term of the contract. The offeror does this in the offer. The offeree must do it in the acceptance."); JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS § 2.21(a), at 85 (6th ed. 2009) ("The common law rule is that a purported acceptance that adds qualifications or conditions operates as a counter offer and thereby a rejection of the offer. . . . Courts have enforced this rule, sometimes called the 'ribbon matching' or 'mirror image' rule, with a rigor worthy of a better cause." (footnotes omitted)); *see* WILLISTON, *supra* note 155, § 6.11, at 107 ("[I]t is generally required in order to form a contract that the offeree pays, in return for the offeror's promise, exactly the consideration that the offeror has sought as the price for the promise.").

Notwithstanding the Texas cases' lip service to the "exact-matching" requirement, a question exists regarding whether an exception is present. This doubt arises from *West Texas Transmission, L.P. v. Enron Corp.*[161] and its progeny.

In *West Texas Transmission*, Valero Transmission Company had a first-refusal right to purchase Enron Corporation's half interest in a natural gas transmission pipeline.[162] Enron reached an agreement to sell its interest in the pipeline to TECO Pipeline Company, subject to the purchase's approval by the Federal Trade Commission.[163] Enron, as required by the first-refusal right, notified Valero about its agreement with TECO.[164] After Valero indicated that it would exercise its first-refusal right, the FTC advised the parties that it would only approve a sale to TECO.[165] Enron not surprisingly refused to sell its pipeline interest to Valero,[166] and Valero sued for specific performance, arguing that the FTC approval condition was an

Many jurisdictions do not require the holder to match "immaterial" terms or conditions in the triggering offer. *E.g.*, Miller v. LeSea Broad., Inc., 87 F.3d 224, 226–28 (7th Cir. 1996) (applying Wisconsin law) (noting that a majority of cases do not require matching of immaterial terms, and those cases do not "let insubstantial variations between the third party's offer and the right holder's offer defeat the right"); Coastal Bay Golf Club, Inc. v. Holbein, 231 So. 2d 854, 858 (Fla. Dist. Ct. App. 1970) ("One offer to purchase matches another only if the essential terms of the offers are identical."); Davis v. Iofredo, 713 N.E.2d 26, 28 (Ohio Ct. App. 1998) ("[I]t has long been recognized that a provision contained in a grant of a right of first refusal that states that the right must be exercised upon the same terms and conditions as are contained in a third party's offer, requires only that the right be exercised upon the same material or essential terms as are contained in such an offer."); Prince v. Elm Inv. Co., 649 P.2d 820, 825 (Utah 1982) ("If the holder of the right of first refusal cannot meet exactly the terms and conditions of the third person's offer, minor variations which obviously constitute no substantial departure should be allowed." (quoting Brownies Creek Collieries, Inc. v. Asher Coal Mining Co., 417 S.W.2d 249, 252 (Ky. 1967))); Matson v. Emory, 676 P.2d 1029, 1033 (Wash. Ct. App. 1981) (holding that the exercise of a first-refusal right constitutes a counteroffer, not an acceptance, when the acceptance differs materially from the triggering offer); *John D. Stump & Assocs.*, 419 S.E.2d at 705 ("[W]here the acceptance of a pre-emptive rightholder varies materially from the terms of the third party's offer, it is viewed as a rejection of the seller's offer and terminates the option right.").

[161] 907 F.2d 1554 (5th Cir. 1990).

[162] *Id.* at 1556.

[163] *Id.*

[164] *Id.* at 1157–58. To obtain approval of the merger transaction in which Enron acquired its interest in the pipeline, Enron entered into a consent decree with the FTC providing that it could divest the pipeline and certain other assets "only in a manner that receives the prior approval of the [FTC]." *Id.* at 1557.

[165] *Id.* at 1558–59.

[166] *Id.* at 1559–60.

immaterial one that it did not have to match.[167]

The Fifth Circuit, applying Texas law, rejected Valero's argument.[168] In doing so, it created a "bad-faith" exception to the "exact-match" requirement: "[T]he owner of property subject to a right of first refusal remains the master of the conditions under which he will relinquish his interest, as long as those conditions are commercially reasonably, imposed in good faith, and not specifically designed to defeat the preemptive rights."[169] Thus, under *West Texas Transmission*, terms or conditions in a triggering offer that are either commercially unreasonable or inserted in bad faith as a "poison pill" to discourage, hinder, or prevent the holder from exercising its first-refusal right are unenforceable and may be ignored by the holder in exercising the first-refusal right.[170]

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[167] *Id.* at 1561.

[168] *Id.* at 1563–64.

[169] *Id.* at 1563. The Fifth Circuit ultimately held that the FTC approval condition was "commercially reasonable, imposed in good faith, and not specifically designed to defeat [Valero's] preemptive rights:"

> (1) "Enron and TECO agreed to include the approval term only after extensive arms length negotiations which resulted in a comprehensive pipeline purchase agreement [and] Enron did not dictate the approval term to TECO, or coerce TECO into accepting that term[;]" and (2) "business venturers routinely subject their contracts to outside approval for financing or creditworthiness in order to guarantee the financial success of the venture [and, f]or Enron, the FTC approval requirement serves a similar function [because] without that term, Enron risked a fine of $10,000 dollars per day under the consent decree if the FTC disapproved of the pipeline acquirer."

Id. at 1563–64.

[170] Other jurisdictions impose a "good-faith" requirement on the grantor. *E.g.*, *Miller*, 87 F.3d at 228 ("[T]he grantor . . . may not act in bad faith, which in this context means may not, for the purposes of discouraging the exercise of the right, procure from the third-party terms that the grantor knows are unacceptable to the holder of the right of first refusal." (citing, among other cases, *West Texas Transmission*)); Or. RSA No. 6, Inc. v. Castle Rock Cellular of Or. Ltd. P'ship., 76 F.3d 1003, 1007 (9th Cir. 1996) (applying Oregon law) (holding that grantor's actions violated the implied covenant of good faith and fair dealing implied in every contract formed under Oregon law, including first-refusal rights); Seessel Holdings, Inc. v. Fleming Cos., 949 F. Supp. 572, 576–77 (W.D. Tenn. 1996) (applying Tennessee law) (following *West Texas Transmission*); *In re* New Era Resorts, LLC, 238 B.R. 381, 386–87 (Bankr. E.D. Tenn. 1999) (applying Tennessee law) (following *West Texas Transmission*); Roeland v. Trucano, 214 P.3d 343, 349 (Alaska 2009) (following *West Texas Transmission*); Brownies Creek Collieries, Inc. v. Asher Coal Mining Co., 417 S.W.2d 249, 252 (Ky. Ct. App. 1967) ("[D]efeat of the right of refusal should not be allowed by use of special, peculiar terms or conditions not made in good faith."); Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 963–64 (Mass. 2004)

The Texas Supreme Court never has considered *West Texas Transmission's* "bad-faith" exception to the "exact-match" requirement, and Texas intermediate appellate courts have not followed the exception uniformly. In the first case to consider the exception, *Texas State Optical, Inc. v. Wiggins*,[171] the First Court of Appeals adopted it:

> [I]f a [grantor] imposes a term in bad faith to defeat a [first-refusal right], the [holder] may validly exercise the [right] while at the same time rejecting the bad-faith terms. . . . [A] holder of a right of first refusal has grounds to remove specific conditions from the contract, or to extract other concessions as part of the agreement, if the offered contract contains conditions, that are not commercially reasonable, are imposed in bad faith, or are specifically designed to defeat the option holder's right.[172]

Two other Texas decisions, the Third Court of Appeals' decision in *Shell v. Austin Rehearsal Complex, Inc.*,[173] and the Second Court of Appeals' decision in *FWT, Inc. v. Haskin Wallace Mason Property*

(implying covenant of good faith and fair dealing in a first-refusal right, but holding that the covenant was not breached); David A. Bramble, Inc. v. Thomas, 914 A.2d 136, 148–49 (Md. 2007) ("We believe that imposing upon the [grantor] and third-party purchaser an implied duty of good faith and fair dealing strikes the proper balance. A good-faith requirement preserves a property owner's right to dispose of property as he, she, or it deems appropriate, thus maintaining marketability of the property. This approach protects, at the same time, the equitable property interest that the preemptioner holds in the encumbered property. . . . We conclude, therefore, that the 'terms upon which the [grantor] would sell her property remains her prerogative so long as she acts in good faith.'" (quoting Matson v. Emory, 676 P.2d 1029, 1032 (Wash. Ct. App. 1984))); St. George's Dragons, L.P. v. Newport Real Estate Group, L.L.C., 971 A.2d 1087, 1100 (N.J. Super. Ct. App. Div. 2009) (quoting *Seessel*, 949 F. Supp. at 576–77); Davis v. Iofredo, 713 N.E.2d 26, 28 (Ohio Ct. App. 1998) (quoting *Brownies Creek*, 417 S.W.2d at 252); Prince v. Elm Inv. Co., 649 P.2d 820, 825 (Utah 1982) ("And defeat of the right of refusal should not be allowed by use of special, peculiar terms or conditions not made in good faith."); Weber Meadow-View Corp. v. Wilde, 575 P.2d 1053, 1055 (Utah 1978) (holding that the grantor's "decision as to . . . terms upon which the [grantor] would sell her property remains her prerogative so long as she acts in good faith and without any ulterior purpose to defeat the right of the [holder]"); *see Matson*, 676 P.2d at 1031 ("The [first-refusal] right is a valuable contract right which should not be rendered illusory by imposing requirement that are impossible to meet.").

[171] 882 S.W.2d 8 (Tex. App.—Houston [1st Dist.] 1994, no writ).

[172] *Id.* at 11 (citation omitted).

[173] *See generally* No. 03-97-00411-CV, 1998 WL 476728 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication).

Management, L.L.P.,[174] also follow *West Texas Transmission*:

> [The] holder of right of first refusal has grounds to remove specific conditions from the contract, or extract other concessions as part of the agreement, if the offered contract contains certain conditions that are not commercially reasonable, are imposed in bad faith, or are specifically designed to defeat the [right]. The [holders] assert that we should not adopt this exception to the general rule because the Fifth Circuit [in *West Texas Transmission*] and the Houston Court of Appeals [in *Texas State Optical*] did not follow Texas law but rather created new law. We disagree. Texas courts have long recognized that the failure of the optionee to strictly comply with the options terms and conditions of the option contract may be excused when such failure is brought about by the conduct of the optionor. We believe the exception stated in *Texas State Optical* is reasonable and applicable to the present case."[175]

West Texas Transmission, however, has been criticized, beginning with the dissent in *Texas State Optical*: "I believe that the *West Texas Transmission* case did not follow Texas law; rather it created new law. The opinion in *West Texas Transmission* is long, loose, and hard to understand."[176] More significantly, in *Abraham Investment Co. v. Payne Ranch, Inc.*,[177] the Seventh Court of Appeals soundly criticized *West Texas Transmission* and refused to adopt its bad-faith exception because it determined that "the Fifth Circuit created these exceptions based in large part on the law of other jurisdictions."[178] Later, the Eleventh Court of

[174] No. 2-08-321-CV, 2009 Tex. App. LEXIS 6953, at *36–37 (Tex. App.—Fort Worth Aug. 27, 2009, pet. denied), *withdrawn*, 301 SW3d 787 (Tex. App.—Fort Worth 2009, pet. filed).

[175] *Shell*, 1998 WL 476728, at *9 (citations omitted). See *supra* note 112 for a detailed discussion of *FWT*.

[176] *Tex. State Optical*, 882 S.W.2d at 12 (Cohen, J. dissenting).

[177] 968 S.W.2d 518 (Tex. App.—Amarillo 1998, pet. denied).

[178] *Id.* at 526–27. The court, however, did not leave holders without a remedy:

> [W]e will directly follow Texas law. In [*Jones v. Gibbs*, 133 Tex. 627, 638–42, 130 S.W.2d 265, 271–73 (1939)], the court explicated the general rule regarding equitable relief in such cases. Equitable relief will be granted when the offeree failed to accept the offer within an option agreement if such failure resulted from fraud, surprise, accident, or mistake. Equally, estoppel principles may apply if the offeror's conduct

Appeals in *McMillan v. Dooley*,[179] citing *Abraham Investment* and the dissent in *Texas State Optical*, noted that "the factors identified in *West Texas Transmission* have not been unanimously embraced by Texas courts as a correct interpretation of Texas law."[180]

Assuming that Texas law recognizes a bad-faith exception to the exact-match requirement, the obvious question is: When is a term or condition in a triggering offer commercially unreasonable or imposed in bad faith to discourage, hinder, or prevent the first-refusal right's exercise? Although sparse, the case law provides some guidance. At the outset, both the motive for the allegedly commercially unreasonable or bad-faith term or condition[181] and its nature and purpose must be considered.[182] In these regards, the case law indicates that: (1) a cash price term in an arm's length transaction never can be commercially unreasonable or imposed in bad faith, even if it exceeds the property's fair market value or what the grantor knows the holder is willing or able to pay;[183] (2) a term or condition that is the result of arm's length negotiation is not commercially unreasonable or imposed in bad faith, whereas a term that is inserted at the grantor's insistence at the last minute or in response to the holder's expressed interest in exercising the first-refusal right may be commercially unreasonable;[184]

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prevented the offeree from properly making his acceptance.

Abraham Inv., 968 S.W.2d at 527.

[179] 144 S.W.3d 159 (Tex. App.—Eastland 2004, pet. denied).

[180] *Id.* at 177.

[181] *See* Miller v. LeSea Broad., Inc., 87 F.3d 224, 228 (7th Cir. 1996); David A. Bramble, Inc. v. Thomas, 914 A.2d 136, 149 (Md. 2007); Prince v. Elm Inv. Co., 649 P.2d 820, 825 (Utah 1982).

[182] *E.g.*, W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1563 (5th Cir. 1990).

[183] *Compare* Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 963–64 (Mass. 2004) (holding that a third party's offer to purchase burdened property for a price exceeding its fair market value was bona fide because "the holder . . . runs the risk that the third party will agree to a price that is above market value or that is above what the holder is able to pay.") *and* Shepherd v. Davis, 574 S.E.2d 514, 521 (Va. 2003) (rejecting argument that a third party's offer was not bona fide because its terms "were designed to make it unreasonable for him to purchase the Property") *with* Raytheon Co. v. Rheem Mfg. Co., 322 F.2d 173, 178–80 (9th Cir. 1963) (applying California law) (holding that grantor's parent corporation's offer for equipment burdened by first-refusal right was not bona fide because its price was not based on market value, but rather on its value to the holder).

[184] *Compare, e.g.*, *W. Tex. Transmission*, 907 F.2d at 1563 ("Where two sophisticated businesses reach a hard fought agreement through lengthy negotiation, it is difficult to conclude that any negotiated term placed in their contract is commercially unreasonable."), *Uno Rests.*, 805 N.E.2d at 965 (holding that term was not imposed in bad faith where "[t]here was no evidence that

and (3) a term or condition that is routinely used in business transactions of the type at issue (or that functions similarly to such a term or condition) is not commercially unreasonable or imposed in bad faith, whereas a peculiar or unusual term or condition may be.[185]

A serious question, however, exists regarding the validity of *West Texas Transmission's* bad-faith exception under Texas law. First, both the dissent in *Texas State Optical* and the Court of Appeals' decision in *Abraham Investment* are correct—*West Texas Transmission's* bad-faith exception is not based on Texas precedent, but on precedent from other jurisdictions.[186] More importantly, the Fifth Circuit, in adopting the exception, failed to recognize that Texas, unlike many other jurisdictions that apply a bad-faith exception, generally does not recognize an implied covenant of good faith and fair dealing in all contracts.[187] *West Texas Transmission's* good-faith

[the grantor] influenced or attempted to influence" the third party's offer), *and Shepherd*, 574 S.E.2d at 521 (rejecting argument that a third party's offer was not bona fide because its terms "were more burdensome for" the holder) *with* Shell v. Austin Rehearsal Complex, Inc., No. 03-97-0411-CV, 1998 WL 476728, at *10 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication) (affirming a jury finding of bad faith because there "was evidence that before [the lessee-holder] expressed its intent to expand, the [lessors-grantors] included a shorter list of restrictive terms in their notices of offer. After being notified of [the lessee-holder's] intent to expand, however, [the lessors-grantors] added restrictive terms to their list. Those actions raise an inference that [the lessors-grantors] consciously set out to defeat [the lessee-holder's] right of first refusal. There was also evidence that although [the lessor-grantor] took the list of terms from a standard commercial lease form, they altered some of the terms to make them more restrictive . . . ."), *Miller*, 87 F.3d at 228 (holding that a grantor may not "procure from the third-party terms that the grantor knows are unacceptable to the holder"), *and Bramble*, 914 A.2d at 150 (holding that "[t]he manner in which the provision was added, i.e., by a hand written addendum attached to the contract of sale, may support an inference that the 'no mining' clause was an after the fact method of frustrating [the holder's] preemptive right by including a term or condition which the parties knew [the holder] would not accept").

[185] *E.g.*, *W. Tex. Transmission*, 907 F.2d at 1563; *Prince*, 649 P.2d at 825.

[186] *See W. Tex. Transmission*, 907 F.2d at 1563. In fact, the citations following *West Texas Transmission's* bad-faith exception include only one Texas case, *Holland v. Fleming*, 728 S.W.2d 820 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.). *Holland*, however, does not support the exception. Rather, in *Holland*, the issue was whether a contract to sell the burdened property, which was canceled three days after its execution and before the grantor gave notice to the holder, triggered a first-refusal right. *Id.* at 823 ("We next consider the [grantor's] contention that the [holders'] right of first refusal never matured, because her earnest money contract with the third party was canceled before she gave or was required to give notice to [the holders] of her election to sell.").

[187] *Compare*, *e.g.*, Petro Franchise Sys., L.L.C. v. All Am. Props., Inc., 607 F. Supp. 2d 781, 793 (W.D. Tex. 2009) (applying Texas law) ("[A] duty of good faith and fair dealing does not

exception, however, is tantamount to the imposition of such a covenant in first-refusal rights.[188]

Second, without an exact-matching requirement, the first-refusal right becomes a significant impediment to the burdened property's marketability, because it allows the holder to impede a sale to a third party simply by refusing to accept an undesirable term or condition of the triggering offer and then claiming that it is commercially unreasonable or imposed in bad faith to discourage, hinder, or prevent the right's exercise.[189] And, the threat to the property's marketability is very real because the determination of good (or bad) faith and commercial (un)reasonableness generally are fact questions that preclude summary judgment and require a full trial on the merits.[190]

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exist in Texas unless intentionally created by express language in a contract or unless a special relation of trust and confidence exists between the parties . . . ." (quoting Lovell v. W. Nat'l Life Ins. Co., 754 S.W.2d 298, 302 (Tex. App.—Amarillo 1988, writ denied))), *and* Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 595 n.5 (Tex. 1992) ("We, however, have specifically rejected the implication of a general duty of good faith and fair dealing in all contracts."), *and* UMLIC VP L.L.C. v. T & M Sales & Envtl. Sys., Inc. 176 S.W.3d 595, 612 (Tex. App.—Corpus Christi 2005, pet. denied) ("The Texas Supreme Court has declined to impose an implied duty of good faith and fair dealing in every contract, though it has recognized that such a duty may arise as a result of 'a special relationship between the parties governed or created by a contract.'" (quoting Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987))), *with* Or. RSA No. 6, Inc. v. Castle Rock Cellular of Or. L.P., 76 F.3d 1003, 1007 (9th Cir. 1996) (applying implied covenant of good faith and fair dealing to first-refusal right), *Uno Rests.* 805 N.E.2d at 964 (same), *and Bramble*, 914 A.2d at 148–49 (same).

[188] *See W. Tex. Transmission*, 907 F.2d at 1563. Because most first-refusal rights are triggered by a third party's bona fide offer and because a bona fide offer is one made in good faith, a holder may argue that an offer made to defeat its first-refusal right is not made in good faith. Any such argument seems incorrect because the third party has no obligation to the holder and because the good-faith requirement relates to the offer, and not to the first-refusal right. *See* discussion *supra* note 64.

[189] *See Bramble*, 914 A.2d at 144 ("[W]ithout [an exact matching requirement], the right [of first refusal] is an impediment to the marketability of property, because it gives the holder of the right a practical power to impede a sale to a third party by refusing to match the third party's offer exactly and then arguing that the discrepancy was immaterial." (quoting Miller v. LeSea Broad., Inc., 87 F.3d 224, 226 (7th Cir. 1996))).

[190] *See W. Tex. Transmission*, 907 F.2d at 1563 ("Whether a specific condition is reasonable must be determined by examining the circumstances of a particular case."); *Miller*, 87 F.3d at 230 (remanding case for determination of whether certain terms of the triggering offer were imposed in bad faith); *Bramble*, 914 A.2d at 149, 150 (holding that "good faith ordinarily is a question of fact for summary judgment purposes" and that "[w]hether a specific term or condition is commercially reasonable, i.e., inserted in good faith, is a case-by-case determination"); Beard v. Whitaker, No. 05-96-01188-CV, 1998 WL 423453, at *3 (Tex. App.—Dallas July 29, 1998, pet.

Third, the exception ignores the inherent nature of first-refusal rights. Inherent in such rights is the fact that the grantor and a third party, not the holder, dictate the triggering offer's terms and conditions.[191] Accordingly, the holder runs the risk that the grantor or the third party may accept, or insist upon, terms and conditions that are unacceptable to the holder.

Fourth, the exception also ignores the fact that the third party is not a party to the first-refusal right and, therefore, is not constrained by it (other than by the third party's duty not to tortiously induce the grantor to breach the right).[192] Rather, the third party is a competitor for the property and nothing precludes it from either outbidding the holder for the property or from accepting, or insisting upon, terms that are acceptable to it, but that it knows or believes are unacceptable to the holder.[193] In fact, the first-refusal right's very nature encourages a third party to offer terms and conditions

denied) (not designated for publication) ("Normally, the issue of good faith involves a question of fact."); Bennett v. Computer Assocs. Int'l, Inc., 932 S.W.2d 197, 204 (Tex. App.—Amarillo 1996, writ denied) ("As to the matter of good faith, we must remember that it inherently involves a question of fact."); *Prince*, 649 P.2d at 826 (remanding case for determination of whether certain terms of the triggering offer were imposed in bad faith).

[191] *See* Crivelli v. Gen. Motors Corp., 215 F.3d 386, 389 (3d Cir. 2000) ("A right of first refusal grants the holder . . . the option to purchase the grantor's . . . property on the terms and conditions of sale contained in a bona fide offer by a third party to purchase such property."); *In re* Bergt, 241 B.R. 17, 20 (Bankr. D. Alaska 1999) ("The holder of such a right has the option to purchase the grantor's real estate on the terms and conditions of sale contained in a bona fide offer by a third party to purchase such real estate . . . .").

[192] *See* Times Herald Printing v. A.H. Belo Corp., 820 S.W.2d 206, 215 (Tex. App.—Houston [14th Dist.] 1991, no writ) (holding that a competitor is free to cause the termination of a business relationship by offering better contract terms or a higher price); Kingsbery v. Phillips Petroleum Co., 315 S.W.2d 561, 576 (Tex. Civ. App.—Austin 1958, writ ref'd n.r.e.) (holding that an oil jobber's business competitor was privileged to use lawful means to induce the jobber's supplier to cancel the jobber's contract and give jobbership to the competitor).

[193] Of course, at the extreme, a grantor's negotiation of a sales price that is greater than the property's market value or greater than what the grantor knows or believes the holder is able or willing to pay should constitute a violation of *West Texas Transmission's* good-faith requirement. But no case has ever so held. *E.g.*, Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 964 (Mass. 2004) (noting that "[n]othing precluded [the third party] from trying to outbid [the holder] by offering a price that [the holder] was unlikely to match."); Rappaport v. Banfield, 924 A.2d 72, 79 (Vt. 2007) ("A prospective buyer may inflate the price for a parcel, or be motivated by a desire to defeat a right of first refusal, and still make a bona fide offer."). It is difficult to understand why a grantor's negotiation of a sales price that it knows exceeds the market price or the price the holder is willing or able to pay does not violate the good-faith requirement, whereas the inclusion of non-cash economic terms or non-economic terms intended defeat the first-refusal right can do so.

that it believes will defeat the right. Imposing a duty of good faith on the grantor effectively requires a grantor to reject offers potentially undesirable to the holder, an obligation clearly exceeding the protection that first-refusal rights were created to provide.[194]

Finally, a good-faith exception to the exact-match requirement discourages thoughtful and careful negotiation and drafting of first-refusal rights in the first instance by providing a failsafe to the thoughtless or careless holder to whom the first-refusal right is purportedly material. In every circumstance in which the exception has been invoked, the dispute regarding the offensive term's or condition's commercial reasonableness or bad faith could have been avoided had the holder negotiated for one of the alternatives to first-refusal rights discussed in Part X *infra* or negotiated a first-refusal right that excluded the terms and conditions later alleged to be commercially unreasonable. An implied good-faith requirement should not be allowed to substitute for the holder's negotiation failures.[195]

For example, in *Shell v. Austin Rehearsal Complex, Inc.*, the Third Court of Appeals, applying *West Texas Transmission*, affirmed a jury verdict finding that the lessors breached their lessee's first-refusal right for additional space in the building where the leased premises were located by including particularly onerous terms in the triggering offer in bad faith to discourage the lessee from exercising its right.[196] The dispute, however, easily could have been avoided had the lessee, instead of a first-refusal right, obtained an option or first-offer right[197] on the additional space or had the first-refusal right only required the lessee to match the triggering offer's rental provision or provided that the provisions in any lease for the additional space, other than the rental provision, be substantially the same as, or not vary materially from, those in the lessee's existing lease.[198]

David A. Bramble, Inc. v. Thomas involved a similar situation.[199] There,

[194] See *infra* Part II.D. for discussion on intended protections of a first-refusal right.

[195] *E.g.*, Tenneco Inc. v. Enter. Prods. Co., 925 S.W.2d 640, 646 (Tex. 1996) (noting that a court should not rewrite a first-refusal right "to insert provisions parties could have included or to imply restraints for which they have not bargained").

[196] No. 03-97-00411-CV, 1998 WL 476728, at *9–10 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication).

[197] *See infra* Part X.A.

[198] *See also supra* note 112 (discussing FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., No. 2-08-321-CV, 2009 WL 4114140, at *5 (Tex. App.—Fort Worth Aug. 27, 2009), *withdrawn*, 301 S.W.3d 787 (Tex. App.—Fort Worth 2009, pet. filed)).

[199] 914 A.2d 136 (Md. 2007).

the Maryland Court of Appeals held that a fact question existed regarding whether a no-mining provision in the triggering offer breached a sand and gravel miner's first-refusal right.[200] Again, the dispute easily could have been avoided had the holder, instead of a first-refusal right, obtained an option or first-offer right on the burdened property or had the first-refusal right been drafted to require the holder only to match the triggering offer's price or by prohibiting any restrictions on the burdened property's use by the holder.

The inconsistency of *West Texas Transmission's* good-faith exception to the exact-match requirement with Texas law does not mean that the holder is without any recourse. To the contrary, once the first-refusal right ripens into an option, the holder has the same protection afforded any optionee under Texas law.[201] That is, equitable relief will be granted when the holder is prevented from exercising the right because of fraud, surprise, accident, mistake, or the grantor's improper conduct.[202]

C. Matching Unique Consideration

Sometimes, the third party will offer land, illiquid stock, or other unique consideration, such as an interest in a partnership, for the grantor's property.[203] As a general rule, the holder of a typical first-refusal right must match the offer in kind, even though a match may be plainly impossible.[204] Courts have regularly rejected the notion that the right implies a promise by the grantor not to accept an offer containing terms the holder cannot match or that a cash offer that arguably leaves the grantor as well off as the third

[200] *Id.* at 138.

[201] *See* Comeaux v. Suderman, 93 S.W.3d 215, 220 (Tex. App.—Houston [14th Dist.] 2002, no pet.) ("A right of first refusal ripens into an option when the owner elects to sell.").

[202] *E.g.*, Jones v. Gibbs, 133 Tex. 627, 639–43, 130 S.W.2d 265, 271–73 (1939) (discussing an optionee's remedies); Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 527 (Tex. App.—Amarillo 1998, pet. denied).

[203] *See* Prince v. Elm Inv. Co., 649 P.2d 820, 823–26 (Utah 1982) (involving the burdened property's exchange for a partnership interest); Weber Meadow-View Corp. v. Wilde, 575 P.2d 1053, 1055 (Utah 1978) (involving the burdened property's sale for $200,000 in cash and a house); Matson v. Emory, 676 P.2d 1029, 1031 (Wash. Ct. App. 1984) (involving the burdened property's exchange for another property).

[204] *See* Kunelius v. Town of Stow, 588 F.3d 1, 12 (1st Cir. 2009) ("[T]he holder of [a right of first refusal] must meet all of the terms and conditions of the offer . . . ."); *In re* New Era Resorts, L.L.C., 238 B.R. 381, 385 (Bankr. E.D. Tenn. 1999) ("[T]he party exercising the right of first refusal must strictly match the terms of the third party's offer . . . .").

party's offer is a match.[205]

Nonetheless, a court, in determining whether the holder's offer is an exact match, should examine the unique consideration's purpose.[206] For example, if the consideration offered for the burdened property, in whole or in part, is other property, the holder's offer of comparable, but different, property would be a match if the grantor's purpose was to obtain a rental property for income generation, but would not be a match if the grantor's purpose was to obtain a vacation or retirement property.[207] Moreover, to

[205] *E.g.*, W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1564–65 (5th Cir. 1990) ("[M]ost courts have insisted that [holders] replicate a myriad of non-price conditions, including terms requiring adequate credit and special payment terms; the assumption of real-estate commissions; additional partnership and land development obligations; the exchange of land parcels rather than a cash transaction; and the purchase of a larger quantity of land . . . . [A] purported acceptance which leaves the [grantor] 'as well off' as a third-party offer, but which modifies, adds to or otherwise qualifies the terms of the offer, generally constitutes a rejection of the offer and a counter offer."); *Weber Meadow-View*, 575 P.2d at 1055 (holding that holder's offer to pay $200,000 in cash and any house of grantor's choosing worth $50,000 or less for burdened property did not match third party's offer of $200,000 in cash plus a specific house); *Matson*, 676 P.2d at 1032–33 ("Allowing [the holder's] all cash offer to meet the terms and conditions of a property exchange would force [the grantor] to dispose of the property in a manner unacceptable to him" and that "offers [that] arguably leave the property owner 'as well off' as does the third-party offer, but which vary materially from it render the purported acceptance a counter offer." (citations omitted)); Daskal, *supra* note 1, at 466 ("The [holder] bears the risk that the [grantor] may only be prepared to sell the burdened property for unique consideration or under unconventional conditions. For example, the [grantor] may be willing to accept a property exchange rather than a cash payment. Or she may be willing to sell only for an interest in a commercial partnership.").

[206] *See* C. Robert Nattress & Assocs. v. CIDCO, 229 Cal. Rptr. 33, 43 (Dist. Ct. App. 1986) ("If the literal matching of terms were required, a [third party] could by offering some unique consideration such as existing trust deed notes, a bag of diamonds or a herd of Arabian horses, effectively defeat the [holder's] right of first refusal. How would the holder of the right of first refusal in such a case make an offer to exercise the right of first refusal on the same terms and conditions as in the triggering offer?"); *see also* Vincent v. Doebert, 539 N.E.2d 856, 861–62 (Ill. App. Ct. 1989) (stating the holder of right of first refusal was not required to match net worth of third-party offeror).

[207] *See, e.g.*, *Prince*, 649 P.2d at 825 ("[W]here the third party offer includes a house that the [grantor] intends to use as a personal residence, the [grantor's] personal preference for that house as a basis for rejecting the [holder's] offer might be eminently reasonable. On the other hand, if the seller intended to use the offered house as a rental property, an explanation in commercial terms is probably required to meet the reasonableness standard."); Nw. Television Club, Inc. v. Gross Seattle, Inc., 634 P.2d 837, 841–42 (Wash. 1981), *modified on other grounds*, 640 P.2d 710 (Wash. 1982) (holding that, where third party's offer was conditioned on sale of a residence, holder's offer, which was based on the sale of another residence, was an exact match because in

the extent that the grantor is under a good-faith requirement, the owner is entitled to insist on a horse, a robe, or a finger ring in lieu of cash as long as it can provide a commercially reasonable explanation for why it prefers such consideration over the holder's proposal.[208] If the holder challenges the commercial reasonableness of the third party's consideration or the grantor's good faith, the mere uniqueness of the third party's consideration "is not a sufficient explanation since, except where both offers are for immediate payment in cash, no two offers are ever identical."[209]

D. Matching Financing Terms

Often the third party will offer to pay for the property over time with the purchase price being secured by other property,[210] guaranteed by another party,[211] or contingent upon the third party's obtaining financing acceptable from a particular source.[212] By and large, courts have held the holder to such details and further have required the holder's offer to be the equivalent of the third party's offer. For example, if the third party offers a lump sum and the holder proposes installment payments with interest, no match is made and the first-refusal right terminates.[213] Similarly, if the third party offers a payment plan, security, or a third-party guarantee, the owner may

both offers the sales were a means of raising the funds for the burdened property's purchase).

[208] *E.g.*, *W. Tex. Transmission*, 907 F.2d at 1563; *Prince*, 649 P.2d at 825; *Matson*, 676 P.2d at 1032; Daskal, *supra* note 1, at 466 ("So long as the [unique] conditions of the sale are commercially reasonable, imposed in good faith, and not specifically designed to defeat the right of first refusal, the right holder will be obligated to match the offer if she wishes to exercise her first-refusal privilege.").

[209] *Matson*, 676 P.2d at 1032 (quoting *Prince*, 649 P.2d at 825).

[210] Chevy Chase Servs., Inc. v. Marceron, 314 F.2d 275, 276 (D.C. Cir. 1963) (third-party offering a first trust on the remaining balance of the purchase price).

[211] Miller v. LeSea Broad., Inc., 87 F.3d 224, 228–29 (7th Cir. 1996) (third party included guarantee by another entity for outstanding obligations, including purchase price).

[212] Christian v. Edelin, 843 N.E.2d 1112, 1115 (Mass. App. Ct. 2006) (owner accepted an offer from a third party subject to a reasonable mortgage contingency date).

[213] *E.g.*, Foster v. Hanni, 841 P.2d 164, 170–71 (Alaska 1992); *accord Chevy Chase Servs.*, 314 F.2d at 277 (holding that the grantor could refuse the holder's offer to give the grantor a junior lien on the burdened tract when the third party offered a senior lien); Smith v. Hevro Realty Corp., 507 A.2d 980, 986 (Conn. 1986) (holding that the holder could not ignore the third party's promise to render a deposit with acceptance); *see Christian*, 843 N.E.2d at 1115 (holding that the holder's acceptance, which was subject to a mortgage contingency, did not match the third party's all cash offer).

reject a holder's offer that is not the equivalent in value and security.[214]

For example, in *McCulloch v. M&C Beauty College, Inc.*, a lessee had a first-refusal right on the building it rented in Santa Ana, California.[215] Because the lessor did not have the money to make the necessary improvements to bring the building into compliance with Santa Ana's seismic code, she decided to accept an offer for its purchase for two $100,000 promissory notes, one unsecured and one secured by a different building owned by the third party that complied with the seismic code.[216] The California Court of Appeals held that the lessor properly rejected the holder's offer because its second note was secured by a building that did not meet the seismic code:

> Of course, we recognize where the prospective purchaser offers a piece of his own property as security for part of the purchase price, the holder . . . can never offer identical terms. That circumstance should not foreclose the holder . . . or his right would be illusory. But where different security is offered by each, it is not immediately apparent to the [grantor] whether the security offered is comparable. Under these unusual circumstances, the [grantor] should have a reasonable time to ascertain whether the security offered is acceptable. That decision must be governed by a reasonable man standard.[217]

E. Matching Owner's Tax Consequences

A rare scenario, but one with potentially significant consequences for the grantor, arises when the grantor's deal with the third party is tax free, but would be taxable if made with the holder. The few cases to consider the question suggest that the holder must compensate the owner for any tax burden resulting from the first-refusal right's exercise that would not have

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[214] *E.g.*, *Miller*, 87 F.3d at 228–29 (holding that if the owner requires a guarantor for the third party's obligation, the owner may reasonably require one from the holder); Coastal Bay Golf Club, Inc. v. Holbein, 231 So. 2d 854, 858 (Fla. Dist. Ct. App. 1970) (holding that the holder's proposed payment schedule with a lower present discounted value than that in the triggering offer was not a match).

[215] 240 Cal. Rptr. 189, 190 (Dist. Ct. App. 1987).

[216] *Id.* at 190–93.

[217] *Id.* at 194.

arisen if the grantor accepted the third party's offer.[218]

F. Setting the Price for the Burdened Property when It Is Sold Either as Part of a Larger Property or as Part of a Package of Properties

When a bona fide, third-party offer is made to purchase property subject to a first-refusal right as part of either a package deal involving multiple properties or the sale of a larger property, the third party may or may not apportion the purchase price between the burdened and unburdened properties.[219] If the third party does not apportion the purchase price, the burdened property's price likely will be based on the proportion of the purchase price that its fair market value bears to the fair market value of the package or the entire parcel, as determined by the trier of fact.[220] However, if the purchase price is based on a unit price, such as a per square foot or per acre price, the holder should be able to purchase the burdened property at its pro-rata share of the total purchase price.[221]

For example, in *Foster v. Bullard*, the holder's first-refusal right on a forty-eight acre tract of land required him to pay an amount "consistent with [a third-party] offer . . . but not less than $750.00 per acre."[222] After the grantor agreed to sell the burdened tract as part of a larger ranch for $650 per acre, the holder sought to exercise his right on the burdened tract for $750 per acre whereas the grantor insisted that he pay $3000 per acre, the tract's alleged fair market value.[223] The Third Court of Appeals, in affirming a decree of specific performance in the holder's favor at $750 per acre, rejected the grantor's argument because no evidence existed that the

[218] *See* Matson v. Emory, 676 P.2d 1029, 1031 (Wash. Ct. App. 1984) (stating that the holder offered to pay an additional amount equal to the negative tax consequences).

[219] *See* Shell Oil Co. v. Trailer & Truck Repair Co., 828 F.2d 205, 208 (3d Cir. 1987) (applying New Jersey law); Pantry Pride Enters., Inc. v. Stop & Shop Cos., 806 F.2d 1227, 1228 (4th Cir. 1986) (applying Virginia law).

[220] *Shell Oil Co.*, 828 F.2d at 210 (applying New Jersey law); *Pantry Pride Enters.*, 806 F.2d at 1231–32 (applying Virginia law); Wilson v. Brown, 55 P.2d 485, 486 (Cal. 1936); Park Plaza, Ltd. v. Pietz, 239 Cal. Rptr. 51, 54 (Dist. Ct. App. 1987), *overruled on other grounds by* Moncharsh v. Heily & Blase, 832 P.2d 899, 906 (Cal. 1992); Brenner v. Duncan, 27 N.W.2d 320, 322 (Mich. 1947); Berry-Iverson Co. of N.D. v. Johnson, 242 N.W.2d 126, 132–33 (N.D. 1976); Wilber Lime Prods., Inc. v. Ahrndt, 673 N.W.2d 339, 342–43 (Wis. Ct. App. 2003).

[221] *See* Foster v. Bullard, 554 S.W.2d 66, 67 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

[222] *Id.*

[223] *Id.* at 67–68.

third party assigned a higher value to the burdened tract than to the remainder of the ranch.[224]

If the third party apportions the price between burdened and unburdened property, the holder may object to the apportionment as excessive because it exceeds the burden property's fair market value or because it is disproportionately large.[225] Most courts hold that the holder should be restricted to the allocated price absent affirmative evidence of bad faith.[226] This simply means that the price allocated to the burdened property cannot be grossly disproportionate to either the value allocated to other properties in the package or the remainder of the property in the parcel, absent evidence establishing that the burdened property is more valuable than the other properties in the package or the remaining property in the parcel. This rule is consistent with the good-faith element of a bona fide offer.[227] To be bona fide, an offer must be honest and sincere.[228] Of course, assigning a grossly disproportionate value to the burdened property is not honest or sincere because the third party would never purchase the property at the price if it were being sold individually.

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[224] *Id.* at 71; *accord* Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 187 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.) (holding that when a package of condominiums, including one burdened with a first-refusal right, was sold for $76.20 per square foot, the lessee-holder could exercise his right at that per square foot price).

[225] *E.g.*, Gleason v. Norwest Mortgage, Inc., 243 F.3d 130, 142–43 (3d Cir. 2001) (applying Minnesota law); *Shell Oil Co.*, 828 F.2d at 208–10; *Pantry Pride Enters.*, 806 F.2d at 1231; *In re* Adelphia Commc'ns Corp., 368 B.R. 348, 352–53, 357–58 (Bankr. S.D.N.Y. 2007) (applying North Carolina law); *Park Plaza*, 239 Cal. Rptr. at 54–55; Uno Rests., Inc. v. Boston Kenmore Realty Corp., 805 N.E.2d 957, 963 (Mass. 2004); Unlimited Equip. Lines, Inc. v. Graphic Arts Ctr., Inc., 889 S.W.2d 926, 939 (Mo. Ct. App. 1994); Samson Res. Co. v. Amerada Hess Corp., 41 P.3d 1055, 1059 (Okla. Civ. App. 2001); *Wilber Lime Prods.*, 673 N.W.2d at 342–43; Rappaport v. Banfield, 924 A.2d 72, 79–80 (Vt. 2007).

[226] *See Park Plaza*, 239 Cal. Rptr. at 54–55; *Uno Rests.*, 805 N.E.2d at 963; *Unlimited Equip. Lines*, 889 S.W.2d at 939; *Samson Res.*, 41 P.3d at 1059; Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 542–43 (Tex. App.—Waco 2008, pet. denied); *Rappaport*, 924 A.2d at 79–80.

Other courts hold that the burdened property's price should be based on the proportion of the purchase price that its fair market value bears to the fair market value of the package or the entire parcel, as determined by the trier of fact. *Shell Oil*, 828 F.2d at 208–10; Pantry Pride Enters., Inc. v. Stop & Shop, Inc., 806 F.2d 1227, 1231 (4th Cir. 1986); *Wilber Lime*, 673 N.W.2d at 342–43.

[227] *See Rappaport*, 924 A.2d at 79 ("A bona fide offer is one made 'honestly and with serious intent' where 'the offeror genuinely intends to bind itself to pay the offered price'" (quoting *Uno Rests.*, 805 N.E.2d at 963)).

[228] See *supra* note 59 and accompanying text.

G. The Dual Option: Attempting to Exercise the Option After Receipt of Notice of a Bona Fide, Third-Party Offer

Oftentimes, a contract or other instrument will contain both a fixed-price option and a first-refusal right. Such provisions commonly are referred to as a dual option.[229] A question often arises regarding the provisions' interplay when a third party offers to purchase the burdened property at a price in excess of the option price and the optionee/holder, instead of exercising the first-refusal right, attempts to exercise the lower priced option.

Courts agree that the answer to the question generally turns on the provision's language.[230] The parties may provide specifically which clause takes precedence and whether the option continues or is extinguished by the third-party offer. When, however, the contract does not answer the question, a split of authority exists.[231] Some courts have held that the optionee/holder can exercise the fixed-price option without regard to the first-refusal right, whereas others have concluded that the option is forfeited or expires if it is not exercised before the optionee/holder receives notice of the third party's offer.[232] The one Texas case to consider the issue directly has held that the optionee/holder, after receiving notice of the third party's offer, must exercise the fixed-price option promptly and, if it fails to do so, the option expires.[233]

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[229] *E.g.*, Smith v. Bertram, 603 N.W.2d 568, 571 (Iowa 1999); M & M Oil Co. v. Finch, 640 P.2d 317, 318 (Kan. Ct. App. 1982); Shepherd v. Davis, 574 S.E.2d 514, 516 (Va. 2003); *see* CORBIN, *supra* note 1, § 11.5, at 495 (referring to "dual purchase provisions").

[230] *M & M Oil*, 640 P.2d at 320 ("Cases dealing with dual options recognize that the terms of the particular clauses control."); *Shepherd*, 574 S.E.2d at 520 ("[C]ourts agree that the interpretation of dual option provisions turns upon the particular language used and that a decision construing a dual option in one agreement will not necessarily be persuasive or controlling in a case involving a different agreement.).

[231] *Shepherd*, 574 S.E.2d at 520.

[232] *E.g.*, *id.* at 520–21 (discussing cases and holding that, under the lease's unambiguous language, once the optionee/holder received notice of the third party's offer, the fixed-priced option could not be exercised); *see also Bertram*, 603 N.W.2d at 571–72 (discussing cases and affirming finding that the parties intended that the optionee/holder forfeit its fixed-price option if it was not exercised before the optionee/holder received notice of the third party's offer); *M&M Oil*, 640 P.2d at 320–21 (discussing cases and holding that where the contract does not specify which provision takes precedence, the optionee/holder forfeits its fixed-price option if it is not exercised before the optionee/holder receives notice of the third party's offer).

[233] *See* Markert v. Williams, 874 S.W.2d 353, 358 (Tex. App.—Houston [1st Dist.] 1994, writ denied). Three other Texas cases have involved dual options. *See* Sinclair Ref. Co. v. Allbritton,

VI. TERMINATION OF THE FIRST-REFUSAL RIGHTS

The typical first-refusal right provides that it must be exercised within a matter of days or it terminates.[234] A number of perplexing questions arise with respect to termination: (1) Does the holder's ability to exercise the right terminate if the triggering offer expires or is revoked before the holder exercises the right?; (2) If the grantor sells property to, or enters into a contract with, a third party in violation of a first-refusal right, can the grantor and third party prevent the holder from exercising the right by rescinding the contract?; (3) What is the effect of a counteroffer by the holder in response to the grantor's notice; (4) Does the right terminate once the holder declines to exercise it?; (5) Is the right personal or assignable?; and (6) Can a right relating to a real property interest run with the land?

A. The Effect of the Triggering Offer's Expiration or Revocation

As discussed above, when the grantor notifies the holder of its decision to accept a third party's bona fide offer for the burdened property, the right matures into an irrevocable option exercisable for the period specified in the right.[235] In light of this fact and in the absence of any language in the right conditioning the holder's exercise of the right on the continued existence of the third-party offer, once triggered, the right is exercisable by the holder for the entire period of time specified in the right, even if the third party's offer terminates or is revoked.[236] Conversely, if the third party's offer

218 S.W.2d 185, 188–89 (Tex. 1949) (holding that the optionee/holder properly exercised the fixed-price option before it received notice of third party's offer); Durrett Dev., Inc. v. Gulf Coast Concrete, L.L.C., No. 14-07-01062-CV, 2009 WL 2620506, at *6 (Tex. App.—Houston [14th Dist.] Aug. 27, 2009, no. pet. h.) (mem. op.) (holding that, under the provisions' unambiguous language, the optionee/holder could exercise the fixed-price option immediately after receiving notice of the third party's offer); Elec. Reliability Council of Tex., Inc. v. Met Ctr. Partners-4, Ltd., No. 03-04-00109-CV, 2005 WL 2312710, at *11 (Tex. App.—Austin Sept. 22, 2005, no pet.) (involving a lease that expressly provided that the fixed-priced option terminated upon the optionee/holder's receipt of notice of a third party's offer).

[234] *See, e.g.*, Bayer v. Showmotion, Inc., 973 A.2d 1229, 1245 (Conn. 2009) (ten-day time period); Old Port Cove Holdings, Inc. v. Old Port Cove Condo. Ass'n One, Inc., 986 So. 2d 1279, 1281 (Fla. 2008) (thirty-day time period); Barco Holdings, L.L.C. v. Terminal Inv. Corp., 967 So.2d 281, 284 (Fla. Dist. Ct. App. 2007) (seven-day time period); Collins v. Collins, No. 13-07-240-CV, 2009 WL 620470, at *1 (Tex. App.—Corpus Christi Mar. 12, 2009, pet. denied) (not designated for publication) (five-day time period).

[235] See cases cited *supra* note 7.

[236] *E.g.*, Egbert R. Smith Trust v. Homer, 731 N.W.2d 810, 812–13 (Mich. Ct. App. 2007), *aff'd*, 745 N.W.2d 754 (Mich. 2008); Glick v. Chocorua Forestlands L.P., 949 A.2d 693, 701

terminates or is revoked before the grantor is required to give notice of the offer to the holder, the right is not triggered, and the holder cannot exercise it.[237]

Once the first-refusal right is triggered by notice, the grantor cannot change the terms and conditions on which the right can be exercised by, for example, sending a new notice.[238]

B. The Effect of the Grantor's Attempt to Rescind a Third-Party Transaction

On rare occasions, after a first-refusal right's breach, usually by a sale of the burdened property to a third party without notice to the holder, the grantor and the third party will attempt to undo the transaction by rescinding or cancelling it. The courts uniformly have rejected such efforts:

> [The grantors] maintain that they should be permitted to rescind their agreement. It has been held that after a breach of contract has given rise to a cause of action, the rights of the innocent party are not affected by an offer to perform

(N.H. 2008); Riley v. Campeau Homes, Inc., 808 S.W.2d 184, 188–89 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd); Henderson v. Nitschke, 470 S.W.2d 410, 414 (Tex. Civ. App.—Eastland 1971, writ ref'd n.r.e.); Mobil Oil Guam Inc. v. Tendido, No. CVA03-006, 2004 WL 1013367, at *10 (Guam May 7, 2004); *But see* Lin Broad. Corp. v. Metromedia 542 N.E.2d 629, 630–31 (N.Y. 1989) (holding that the holder could not exercise the first-refusal right after the third party's offer was withdrawn).

[237] *See* Holland v. Fleming, 728 S.W.2d 820, 823 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.) ("Upon executing the sales contract, the [grantor] had a reasonable amount time within which to notify [the holder] of the terms of the proposed sale. The earnest money contract was in effect for only several days before it was canceled by mutual agreement. When the sales contract ended, that terminated the appellant's obligation to give notification to the [holder]. There was no longer a pending sale, and the preemptive right of purchase never matured into an enforceable option.").

[238] *E.g.*, FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., No. 2-08-321-CV, 2009 WL 4114140, at *5 (Tex. App.—Fort Worth Aug. 27, 2009, pet. denied), *withdrawn*, 301 S.W.3d 787 (Tex. App.—Fort Worth 2009, pet. filed) ("Once the property owner has given notice of his intent to sell on the terms contained in the third-party offer, the terms of the option cannot be changed for as long as the option is binding on the property owner." (quoting City of Brownsville v. Golden Spread Elec. Coop., Inc., 192 S.W.3d 876, 880 (Tex. App.—Dallas 2006, pet. denied))); Nat'l Adver. Co. v. Potter, No. 01-06-01042-CV, 2008 WL 920338, at *3 (Tex. App.—Houston [1st Dist.] Apr. 3, 2008, pet. denied) (mem. op.) (same); Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 526 (Tex. App.—Amarillo 1998, pet. denied) (same). Of course, if the notice contains an error, the grantor should be able to correct it.

> by the party who has broken the contract. This rule should also apply to those who seek to undo their breach by rescission. It follows from this ruling that one cannot undo the legal effect of a breach by restoring the status quo as it existed prior to the breach.[239]

C. The Effect of the Holder's Rejection of the Triggering Offer or a Counteroffer

Although requests for information by holders or even attempts to negotiate alternative provisions should not constitute a rejection of the offer or waiver of the first-refusal right, only a timely exercise of the right on the terms in the triggering offer will preempt the third party's right to acquire the burdened property.[240] In addition, the right terminates if the holder timely exercises it without qualification but later refuses to execute a contract on the same terms as the triggering offer.[241]

This does not mean, however, that after the holder exercises the right, the grantor and the holder cannot agree to modify their contract. For example, in *Northern Plains Alliance, L.L.C. v. Mitzel*, a divorce decree gave the husband a first-refusal right to purchase a building located on land

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[239] Perritt Co. v. Mitchell, 663 S.W.2d 696, 699 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.) (citation omitted); *accord* Minton v. Crawford, 719 So. 2d 743, 746 (La. Ct. App. 1998) ("Once the right of first refusal was violated, [the holder] had a cause of action which could not be 'undone' by the subsequent actions of [the grantor]."); Long v. Wayble, 618 P.2d 22, 25 (Or. Ct. App. 1980) (holding that the grantor's listing of property for sale with real-estate broker triggered fixed-price, first-refusal right and grantor could not "later circumvent that obligation by withdrawing the property from the market").

[240] *See Abraham Inv.*, 968 S.W.2d at 526 (holding that although the holder's counteroffer before the expiration of the time to exercise the first-refusal right did not terminate the right, the holder "still needed to accept according to the terms and manner prescribed"); *cf.* CORBIN, *supra* note 1, § 11.8, at 530 (noting that the optionee's counteroffer before the option's expiration does not terminate the option).

[241] *E.g.*, Green v. First Am. Bank & Trust, 511 So. 2d 569, 575 (Fla. Dist. Ct. App. 1987) ("We . . . hold that the original offer contained in [the holder's] lawyer's letter . . . was not a sufficient exercise of the [first-refusal right] because, as [the holder] admits, he never intended to match the [third party's] offer . . . ."); Seessel Holdings, Inc. v. Flemings Cos., 949 F. Supp. 572, 578 (W.D. Tenn. 1996) ("[M]erely electing to exercise a first-refusal right is not sufficient if a right holder subsequently refuses to timely enter into a contract matching the terms of the third-party agreement."); *Abraham Inv.*, 968 S.W.2d at 525–26 (holding that the holder's exercise of a first-refusal right was invalid when the holder did not intend to perform the triggering offer's terms).

leased from a railroad.[242] By a written agreement, which provided for a March 22, 2002, closing date, the plaintiff offered to purchase the building subject to both the husband's first-refusal right and the purchaser's successful purchase of the underlying land from the railroad.[243] After being notified of the plaintiff's offer, the husband exercised the right.[244] Although he was successful in negotiating a purchase of the underlying land from the railroad, he was unable to close its purchase until after the March 10, 2002, closing date in the plaintiff's offer, and the wife agreed to extend the closing date for the building's purchase until after the husband closed on the underlying land's purchase.[245] The plaintiff then sued the husband, claiming that his failure to close the building's purchase on March 10, 2002, intentionally interfered with its contract with the wife.[246]

The North Dakota Supreme Court, in rejecting the plaintiff's argument, reasoned that "the moment the right of first refusal is exercised, the contract between [the wife] and [the plaintiff] is no longer in effect" and subject to interference and that the husband and wife thereafter were free to modify their agreement, including the closing date.[247]

Most first-refusal rights are drafted so that they apply to each sale of the burdened property during the right's term. For example, if a lease gives the tenant a first-refusal right on the leased premises during the lease's term, it does not terminate the first time the leased premises are sold, but rather applies to each sale of them during the lease's term unless the lease provides to the contrary.[248]

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[242] 663 N.W.2d 169, 170–71 (N.D. 2003).

[243] *Id.* at 171.

[244] *Id.*

[245] *Id.*

[246] *Id.*

[247] *Id.* at 172–73, 175; *accord* Harper v. Great Salt Lake Council, Inc., 976 P.2d 1213, 1218 (Utah 1999). This would not be the case, however, if the third party and grantor entered into a contract conditioned on the holder matching the contract's terms exactly. *See* Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 528 (Tex. App.—Amarillo 1998, pet. denied); *see also infra* text accompanying notes 298–304.

[248] *See, e.g.*, 6500 Cedar Springs, L.P. v. Collector Antique, Inc., No. 05-98-00386-CV, 2000 WL 1176586, at *4 (Tex. App.—Dallas Aug. 21, 2000, no pet.) (not designated for publication) (involving a first-refusal right in a commercial lease); Imco Oil & Gas Co. v. Mitchell Energy Corp., 911 S.W.2d 916, 921 (Tex. App.—Fort Worth 1995, no writ) (involving a first-refusal right in a joint operating agreement); Foster v. Bullard, 496 S.W.2d 724, 736 (Tex. Civ. App.—Amarillo 1973, writ ref'd n.r.e.) (involving a first-refusal right in a deed); *see also* Foster v. Hanni, 841 P.2d 164, 171 (Alaska 1992) (involving first-refusal right in a lease); Sand v. London

D. The Assignability of First-Refusal Rights

In Texas, almost all contracts are assignable in the absence of a contract provision to the contrary.[249] Thus, first-refusal rights generally are assignable.[250] Moreover, when the right (or the contract containing it) expressly provides that the right is assignable, a Texas court likely will defer to that provision even if the contract is personal.[251]

In the real-estate context, not all covenants are the same. Some are personal covenants, whereas others are real covenants. The primary distinction between them "is that real covenants run with the land, binding the heirs and assigns of the covenanting parties, and personal covenants do not."[252] For a covenant to run with the land: (1) privity of estate must exist between the contracting parties; (2) the covenant must specifically bind the parties; (3) the covenant must touch and concern the land; and (4) the parties must have intended the covenant to run with the land.[253] By definition, a real covenant is enforceable against the covenantor and his or

& Co., 121 A.2d 559, 562 (N.J. Super. Ct. App. Div. 1956) (involving a first-refusal right in a lease); Cipriano v. Glen Cove Lodge #1458, B.P.O.E., 801 N.E.2d 388, 390–93 (N.Y. 2003) (involving a first-refusal right in a real-estate sales contract).

[249] *E.g.*, Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 596 (Tex. 1992); Zale Corp. v. Decorama, Inc., 470 S.W.2d 406, 408 (Tex. Civ. App.—Waco 1971, writ ref'd n.r.e.); RESTATEMENT (SECOND) OF CONTRACTS §§ 318, 320 (1981); *see also* Tex. Bus. & Com. Code Ann. § 2.210(b) (Vernon 2009) (providing that, under the Uniform Commercial Code, all sales contracts are assignable unless the assignment would materially change the other party's duties, materially increase the burden or risk imposed on the other party, or materially impair the other party's chance of obtaining return performance).

The principal exception to the general assignability rule is that "a contract that relies on the personal trust, skill, character or credit of the parties, may not be assigned without the consent of the parties." *E.g.*, *Crim Truck & Tractor*, 823 S.W.2d at 596.

Some jurisdictions hold that first-refusal rights are personal, and, therefore, not assignable, to avoid a conflict with the rule against perpetuities. *E.g.*, Park Station L.P. v. Bosse, 835 A.2d 646, 653 (Md. 2003); Jones v. Stahr, 746 N.W.2d 394, 399 (Neb. Ct. App. 2008); Metro. Transp. Auth. v. Bruken Realty Corp., 492 N.E.2d 379, 384 (N.Y. 1986).

[250] Walker v. Horine, 695 S.W.2d 572, 578 (Tex. App.—Corpus Christi 1985, no writ.) (holding written permission is not required for assignment).

[251] *E.g.*, *Zale Corp.*, 470 S.W.2d at 408.

[252] Tarrant County Appraisal Dist. v. Colonial Country Club, 767 S.W.2d 230, 235 (Tex. App.—Fort Worth 1989, writ denied); *accord* 718 Assocs., Ltd. v. Sunwest N.O.P., Inc., 1 S.W.3d 355, 364 (Tex. App.—Waco 1999, pet. denied).

[253] *E.g.*, Inwood N. Homeowners' Ass'n v. Harris, 736 S.W.2d 632, 635 (Tex. 1987); First Permian, L.L.C. v. Graham, 212 S.W.3d 368, 372 (Tex. App.—Amarillo 2006, pet. denied); Ehler v. B.T. Suppenas Ltd., 74 S.W.3d 515, 520 (Tex. App.—Amarillo 2002, pet. denied).

her heirs, successors, and assigns by the covenantee and his or her heirs, successors, and assigns.[254]

Although the Texas Supreme Court has never considered the question, Texas intermediate appellate courts uniformly have held that a first-refusal right can be a real covenant.[255] These cases, however, simply have assumed that the right touched and concerned the holder's land.[256]

Traditionally, to touch and concern land, a covenant must both burden the covenantor's land, that is, the grantor's land in the case of a first-refusal right, and benefit the covenantee's land, that is, the holder's land in the case of such a right.[257] Arguably, a first-refusal right at least slightly burdens the grantor's land because the grantor must comply with the right before selling it. Whether the right imposes a benefit on the holder's land is problematic, however, because a first-refusal right rarely benefits the holder's land (as

[254] *E.g.*, *Tarrant County Appraisal Dist.*, 767 S.W.2d at 235.

[255] *E.g.*, *First Permian*, 212 S.W.3d at 372; McMillan v. Dooley, 144 S.W.3d 159, 185 (Tex. App.—Eastland 2004, pet. denied); Sanchez v. Dickinson, 551 S.W.2d 481, 485 (Tex. Civ. App.—San Antonio 1977, no writ); Foster v. Bullard, 496 S.W.2d 724, 736–37 (Tex. Civ. App.—Amarillo 1973, writ ref'd n.r.e.); Stone v. Tigner, 165 S.W.2d 124, 127 (Tex. Civ. App.—Galveston 1942, writ ref'd).

Courts from other jurisdictions are split on the issue. Some, like Texas courts, hold that first-refusal rights can be real covenants. *E.g.*, Sherwood Ford, Inc. v. Ford Motor Co., 860 F. Supp. 659, 662 (E.D. Mo. 1994) (applying Missouri law); Coordinated Fin. Planning Corp. v. Steffan, 65 B.R. 711, 712 (B.A.P. 9th Cir. 1986) (applying California law); Tadros v. Middlebury Med. Ctr., Inc., 820 A.2d 230, 236 (Conn. 2003); No-Pink, Inc. v. Ellison, No. 215457, 2001 WL 721397, at *2 (Mich. Ct. App. Feb. 27, 2001) (unpublished opinion); L&M Corp. v. Loader, 688 P.2d 448, 449 (Utah 1984); Mitchell v. Mitchell, No. 93-3312, 1994 WL 463957, at *3 n.1 (Wis. Ct. App. Aug. 30, 1994) (unpublished disposition). Others, however, hold that first-refusal rights are not real covenants because they do not touch or concern the land as they neither burden the grantor's land nor benefit the holder's land. *E.g.*, *In re* Fleishman, 138 B.R. 641, 645 (Bankr. E.D. Mass. 1992) (applying Massachusetts law); Ricketson v. Bankers First Sav. Bank, 503 S.E.2d 297, 298–300 (Ga. Ct. App. 1998); Rosewood Constr. Corp. v. Mass. Youth Soccer Ass'n, No. 2008-01411, 2008 WL 5505483, at *5 (Mass. Super. Ct. Dec. 18, 2008); Clarke v. Caldwell, 521 N.Y.S.2d 851, 854 (N.Y. App. Div. 1987); Feider v. Feider, 699 P.2d 801, 803–04 (Wash. Ct. App. 1985).

[256] *See Sanchez*, 551 S.W.2d at 485; *Bullard*, 496 S.W.2d at 736–37; *Stone*, 165 S.W.2d at 127.

[257] *E.g.*, Westland Oil Dev. Corp. v. Gulf Oil Corp., 637 S.W.2d 903, 911 (Tex. 1982) (discussing requirement generally); Berkman v. City of Keene, No. 10-08-00073, 2009 Tex. App. LEXIS 5494, at *10–11 (Tex. App.—Waco July 15, 2009, no. pet. h.); *Feider*, 699 P.2d at 803–04 (discussing requirement in the context of a first-refusal right); Howard R. Williams, *Restrictions on the Use of Land: Covenants Running with the Land at Law*, 27 TEX. L. REV. 419, 429 (1949) (discussing requirement generally).

opposed to the holder personally). And, if it must benefit the land, an heir, successor, or assign who does not own an interest in land cannot enforce the right against the original grantor or his or her heir, successor, or assign because by definition the right does not benefit the holder's land.[258]

Although both the leading commentator on Texas real covenants and the Third Restatement of Property have concluded that a covenant can be a real covenant even if it does not benefit the covenantee's land,[259] Texas law is unclear on the issue.[260] The only case to directly consider it in the context of a first-refusal right—*First Permian, L.L.C. v. Graham*—held that a right is personal and unenforceable by the holder's heirs, successors, or assigns if the right does not benefit the heir's, successor's, or assignee's land when the heir, successor, or assign seeks to enforce it.[261]

In *First Permian*, Graham's father, aunts, and uncles assigned their interests in certain oil and gas leases to Pan American Petroleum Corporation in consideration of a production payment and a first-refusal right on the leases.[262] Over the years, the leases were sold to a number of parties, with First Permian ultimately acquiring them.[263]

In 2002, First Permian entered into a contract to sell all of its oil and gas assets, including the Grahams' leases, to Energen Resources Company.[264] It, however, refused to allow Graham, as his father's, aunts', and uncles' heir, to exercise the assignment's first-refusal right, claiming that it had

[258] *First Permian*, 212 S.W.3d at 371–72 (refusing to enforce a first-refusal right because the holder no longer owned an interest in land).

[259] Williams, *supra* note 257, at 453 (concluding that, under Texas law, a covenant runs with the land "so long [the] burden touches or concerns the covenantor's land irrespective whether [a] benefit touches or concerns the [covenantee's] land"); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.2 (2000) ("Neither the burden nor the benefit of a covenant is required to touch or concern the land in order for the covenant to be valid as a servitude.").

[260] *Compare In re* El Paso Refinery, L.P., 302 F.3d 343, 356–57 (5th Cir. 2002) (noting the lack of clarity and pointing out that *Westland Oil Development Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 911 (Tex. 1982), and *Wimberly v. Lone Star Gas Co.*, 818 S.W.2d 868, 872 (Tex. App.—Fort Worth 1991, writ denied), can be read as dispensing with the benefit requirement, and enforcing covenants upon a burden only showing), *with Berkman*, 2009 Tex. App. LEXIS 5494, at *10 n.5 ("Our Supreme Court has not adopted the view of the Restatement (Third), and absent guidance from that Court, we decline to do so.").

[261] 212 S.W.3d 368, 373 (Tex. App.—Amarillo 2006, pet. denied).

[262] *Id.* at 369.

[263] *Id.* at 369–70.

[264] *Id.* at 370.

expired when the production payment was fully paid out in 1975.[265]

On appeal from an adverse judgment in Graham's favor, First Permian first argued that the trial court misconstrued the assignment because, under its express terms, the first-refusal right was expressly tied to the production payment so that the right terminated when the production payment was fully paid out.[266] Alternatively, it argued that, as the production payment had been paid out decades before, the right was unenforceable because it was a personal, rather than a real, covenant since Graham did not own a real property interest at the time of the Energen transaction.[267]

The Seventh Court of Appeals sided with First Permian on both counts.[268] It first held that, under the assignment's express language, "the [first-refusal] right was intended to exist only for so long as necessary to protect the interest of the Grahams, their heirs, successors, and assigns in the full payment for the leases."[269] Notwithstanding the dispositive nature of this holding, the court, in dicta, also concluded that even if the first-refusal right had not expired with the production payment's payout, Graham still could not have enforced it in connection with the Energen transaction because "a real covenant can only be enforced by the owners of the land the covenant was intended to benefit" and Graham owned no real property interest at the time of that transaction in light of the production payment's earlier payout.[270] In arriving at this conclusion, the court distinguished *McMillan v. Dooley*:

> [U]pon closer examination, the *McMillan* covenant had significantly more of the characteristics of a personal covenant. The facts of *McMillan* show that the parties, at the time of execution of the agreement in question, did not intend that Johnson [the holder] would be required to have an interest in the land to support the enforcement of his preferential right. Rather, the parties intended that Johnson have a personal right to enforce the covenant. Therefore, the covenant in *McMillan* does not possess all four of the requirements of a covenant running with the land, but

[265] *Id.*

[266] *Id.*

[267] *Id.* at 370–71.

[268] *Id.* at 373.

[269] *Id.* at 371–72.

[270] *Id.* at 372.

rather constituted a personal covenant.[271]

The court's conclusion, however, involves a bit of double speak because it wholly ignores the court's earlier holding that the first-refusal right in the assignment ran with the land.[272] Moreover, the court only cited a single case in support of its holding, *Davis v. Skipper*, which involved a restrictive covenant, not a first-refusal right, and which stands for the wholly unremarkable proposition that when such a covenant is created to benefit other land, only the current owner of the benefitted land has standing to enforce it.[273] Further, the court in *First Permian* ignored the fact that a first-refusal right creates an interest in land.[274] Finally, the court's distinguishment of two other Texas cases holding that first-refusal rights run with the land, *Sanchez v. Dickinson*[275] and *Stone v. Tigner*,[276] was superficial at best. Although the court in *First Permian* correctly pointed out that the holder in each case owned a real property interest, it ignored the fact that nothing in either case explained how the first-refusal right benefited the holder's interest.[277]

To the extent that a first-refusal right touches and concerns the land, the determination whether the right is real or personal depends on whether the

[271] *Id.* at 372. This is a reasonable way to distinguish *McMillan* because the covenant's nature as a real or personal covenant was irrelevant to Johnson's ability to enforce it. *Id.* Nonetheless, the distinction ignores the *McMillan* court's clear statement that Johnson's first-refusal right ran with the land. *Id.* at 373.

[272] *Id.* at 370–71.

[273] *See* 125 Tex. 363, 371, 83 S.W.2d 318, 321–22 (1935).

[274] Ayres v. Townsend, 598 A.2d 470, 474 (Md. 1991); Pace v. Culpepper, 347 So. 2d 1313, 1317–18 (Miss. 1977); Lake of the Woods Ass'n v. McHugh, 380 S.E.2d 872, 875 (Va. 1989); *cf.* Madera Prod. Co. v. Atl. Richfield Co., 107 S.W.3d 652, 660 (Tex. App.—Texarkana 2003, no pet.) (holding that an option creates an interest in land); Hitchcock Props., Inc. v. Levering, 776 S.W.2d 236, 238–39 (Tex. App.—Houston [1st Dist.] 1989, writ denied) (same).

[275] 551 S.W.2d 481, 485 (Tex. Civ. App.—San Antonio 1977, no writ).

[276] 165 S.W.2d 124, 127 (Tex. Civ. App.—Galveston 1942, writ ref'd).

[277] *First Permian*, 212 S.W.3d at 372. The court in *First Permian* also distinguished *Westland Oil Development Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903 (Tex. 1982), on the ground that the covenantee held an interest in land—an overriding royalty. *See First Permian*, 212 S.W.3d at 372–73. However, the Texas Supreme Court, in holding that the covenant in *Westland Oil Development Corp.* ran with the land, did not rely on that fact, did not explain how the covenant benefitted the covenantee's overriding royalty, and clearly suggested that a covenant can run with the land only if it burdens the covenantor's land. *See Westland Oil Dev.*, 637 S.W.2d at 911; *accord In re* El Paso Refinery, L.P., 302 F.3d 343, 357 (5th Cir. 2002) (pointing out that *Westland Oil Development* can be read as dispensing with the benefit requirement, and enforcing covenants upon a burden only showing).

parties to the contract or other instrument creating the right intended it to run with the land.[278] If the contract or other instrument provides that the contract's covenants are binding on the parties' heirs, successors, and assigns or otherwise indicates that it is intended to run with the land, the first-refusal right is a real covenant:[279]

> To determine if a preemptive right is personal to either the grantee or the grantor, other jurisdictions addressing the issue look exclusively to the language of the contract. They focus on whether the language states that the right extends to heirs or assign of either party, or otherwise indicates that the parties intended [the right] to be binding beyond either of their lives. Absent such language, the preemptive right is deemed to be personal.[280]

VII. THE HOLDER'S REMEDIES FOR BREACH OF A FIRST-REFUSAL RIGHT

The typical remedy sought by a holder for the breach of a first-refusal right relating to real property is specific performance.[281] Specific

[278] *See First Permian*, 212 S.W.3d at 372.

[279] *See id.*

[280] Davis v. Anthony, No. 97 CO 19, 1998 WL 896453, at *2 (Ohio Ct. App. Dec. 21, 1998) (quoting Stratman v. Sheetz, 573 N.E.2d 776, 778 (Ohio Ct. App. 1989)); *accord* Mobil Exploration & Producing N. Am., Inc. v. Graham Royalty Ltd., 910 F.2d 504, 507 (8th Cir. 1990) (applying Arkansas law) (same); Tadros v. Middlebury Med. Ctr., Inc., 820 A.2d 230, 244 (Conn. 2003) (right of refusal runs with the land); McMillan v. Dooley, 144 S.W.3d 159, 164 (Tex. App.—Eastland 2004, pet. denied) (first-refusal right runs with the land because it is binding on successors and assigns); Sanchez v. Dickinson, 551 S.W.2d 481, 484–85 (Tex. Civ. App.—San Antonio 1977, no writ) (same); Mitchell v. Mitchell, No. 93-3312, 1994 WL 463957, at *3 n.1 (Wis. Ct. App. Aug. 30, 1994) (same); *see* Mulvey v. Mobil Producing Tex. & N.M., Inc., 147 S.W.3d 594, 607 (Tex. App.—Corpus Christi 2004, pet. denied) (holding that assignee of joint-operating agreement had standing to assert claim under the agreement's first-refusal right).

[281] Specific performance is an equitable remedy that compels a party to perform a contract as promised. *E.g.*, S. Plains Switching, Ltd. v. BNSF Ry. Co., 255 S.W.3d 690, 703 (Tex. App.—Amarillo 2008, pet. denied); Estate of Griffin v. Sumner, 604 S.W.2d 221, 225 (Tex. Civ. App.—San Antonio 1980, writ ref'd n.r.e.). It is usually available when recovery of money damages for the contract's breach is inadequate to compensate the non-breaching party for the loss of its benefit of the bargain, and the contract's subject matter is real estate or personal property having a special, peculiar, or unique character. *E.g.*, DiGiuseppe v. Lawler, 269 S.W.3d 588, 593 (Tex. 2008) (specific performance granted to enforce real property contract); Stafford v. S. Vanity Magazine, Inc., 231 S.W.3d 530, 535 (Tex. App.—Dallas 2007, pet. denied) (specific

performance can be obtained from the grantor if it still owns the property[282] or from a third party who purchased the property with actual or constructive notice of the first-refusal right.[283] To be entitled to specific performance, the holder must show that it: (1) was willing, ready, and able to exercise the right and purchase the burdened property on the same terms and conditions as the third party at the time the first-refusal right was breached;[284] and (2) it performed, tendered performance, or was excused from performing the contract containing the first-refusal right because the grantor repudiated the contract by, for example, selling the burdened property to a third party.[285]

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performance granted to enforce stock purchase agreement for stock in closely held corporation that had no ascertainable value); Scott v. Sebree, 986 S.W.2d 364, 368–69 (Tex. App.—Austin 1999, pet. denied); Am. Apparel Prods. v. Brabs, Inc., 880 S.W.2d 267, 269 (Tex. App.—Houston [14th Dist.] 1994, no writ) ("Specific performance of a contract involving personal property may be granted where the property has a special, peculiar, or unique value or character and the plaintiff would not be adequately compensated for his loss by money damages."); Madariaga v. Morris, 639 S.W.2d 709, 712 (Tex. App.—Tyler 1982, writ ref'd n.r.e.) (specific performance granted to enforce contract containing option to purchase business that included goodwill and a product formula).

A decree of specific performance may be worded in the negative to enjoin a contracting party from violating its contract. *E.g.*, Cytogenix, Inc. v. Waldroff, 213 S.W.3d 479, 487 (Tex. App.—Houston [1st Dist.] 2006, pet. denied); Fuller v. Walter E. Heller & Co., 483 S.W.2d 348, 351 (Tex. Civ. App.—Dallas 1972, no writ).

[282] *See* Briggs v. Sylvestri, 714 A.2d 56, 60 (Conn. Ct. App. 1998); C&J Delivery, Inc. v. Vinyard & Lee & Partners, Inc., 647 S.W.2d 564, 569 (Mo. Ct. App. 1983); Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184, 188 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd); CORBIN, *supra* note 1, § 11.3, at 471, 483.

[283] *E.g.*, Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518, 527 (Tex. App.—Amarillo 1998, pet. denied); *see also* Koch Indus., Inc. v. Sun Co., 918 F.2d 1203, 1211 (5th Cir. 1990) (applying Texas law); Sherwood Ford, Inc. v. Ford Motor Co., 860 F. Supp. 659, 663 (E.D. Mo. 1994) (applying Missouri law); Meyer v. Warner, 448 P.2d 394, 397 (Ariz. 1968); Atchison v. City of Englewood, 568 P.2d 13, 21 (Colo. 1977); *C&J Delivery*, 647 S.W.2d at 569; Larson Operating Co. v. Petroleum, Inc., 84 P.3d 626, 632 (Kan. Ct. App. 2004); Hancock v. Dusenberry, 715 P.2d 360, 365 (Idaho 1986); No-Pink, Inc. v. Ellison, No. 215457, 2001 WL 721397, at *3 (Mich. Ct. App. Feb. 27, 2001); Winberg v. Cimfel, 532 N.W.2d 35, 41 (Neb. 1995); Glick v. Chocorua Forestlands L.P., 949 A.2d 693, 701 (N.H. 2008); H.G. Fabric Discount, Inc. v. Pomerantz, 515 N.Y.S.2d 823, 825 (App. Div. 1987); Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 543 (Tex. App.—Waco 2008, pet. denied); Chapman v. Mut. Life Ins. Co., 800 P.2d 1147, 1150–51 (Wyo. 1990).

[284] *Abraham Inv.*, 968 S.W.2d at 527; *Riley*, 808 S.W.2d at 188; *Briggs*, 714 A.2d at 60; *see Digiuseppe*, 269 S.W.3d at 600 (discussing specific performance in general).

[285] *E.g.*, *Digiuseppe*, 269 S.W.3d at 594; *Stafford*, 231 S.W.3d at 535; Riley v. Powell, 665 S.W.2d 578, 581 (Tex. App.—Fort Worth 1984, writ ref'd n.r.e.).

An action for damages against the holder typically is an alternative to an action for specific performance,[286] and the holder's only contractual remedy if a third-party purchaser did not have actual or constructive notice of the first-refusal right.[287] "The universal rule for measuring damages for the breach of a contract is just compensation for the loss or damage actually sustained."[288] The damages recoverable in a contract action are: (1) direct (or general) damages and (2) special (or consequential) damages.[289] Direct damages represent the compensation for losses that naturally and necessarily result from the contract's breach.[290] Because the loss naturally and necessarily resulting from a first-refusal right's breach is the loss of an enforceable option to purchase the burdened property, the direct damages for the breach are the same as those for an option contract's breach[291]—the difference between the property's fair market value and the price paid (or

[286] *See Koch*, 918 F.2d at 1214; *Meyer*, 448 P.2d at 397; Phipps v. CW Leasing, Inc., 923 P.2d 863, 866 (Ariz. Ct. App. 1996); *Atchison*, 568 P.2d at 22; Anderson v. Armour & Co., 473 P.2d 84, 89 (Kan. 1970); Barela v. Locer, 708 P.2d 307, 311 (N.M. 1985); *C&J Delivery*, 647 S.W.2d at 569; Shell v. Austin Rehearsal Complex, Inc., No. 03-97-0411-CV, 1998 WL 476728, at *11 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication); CORBIN, *supra* note 1, § 11.3, at 471–72, 483.

A holder generally cannot recover both specific performance and actual damages. *E.g.*, Paciwest, Inc. v. Warner Alan Props., 266 S.W.3d 559, 574–75 (Tex. App.—Fort Worth 2008, no pet.); *Scott*, 986 S.W.2d at 370. In appropriate circumstances, however, a holder, in addition to specific performance, may recover consequential damages caused by the late performance. *E.g.*, *Paciwest*, 266 S.W.3d at 575; Heritage Hous. Corp. v. Ferguson, 674 S.W.2d 363, 365–66 (Tex. App.—Dallas 1984, writ ref'd n.r.e.). Such compensation is not considered damages for the contract breach, but instead equalizes losses caused by the delay by offsetting them with money damages. For example, the holder may recover the property's rental value from the time of its demand on the grantor or the third party for performance and the tender of the purchase price or damages for increased construction or financing costs. *See, e.g.*, *Paciwest*, 266 S.W.3d at 574–75.

[287] *E.g.*, *Barela*, 708 P.2d at 311.

[288] Phillips v. Phillips, 820 S.W.2d 785, 788 (Tex. 1991); *accord Koch*, 918 F.2d at 1214 (same).

[289] Continental Holdings, Ltd. v. Leahy, 132 S.W.3d 471, 475 (Tex. App.—Eastland 2003, no pet.) (citing Frost Nat. Bank v. Heafner, 12 S.W.3d 104, 111 n.5 (Tex. App.—Houston [1st Dist.] 1999, pet. denied)).

[290] *E.g.*, Baylor Univ. v. Sonnichsen, 221 S.W.3d 632, 636 (Tex. 2007); Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997).

[291] *See Koch*, 918 F.2d at 1214; Miga v. Jenson, 96 S.W.3d 207, 215 (Tex. 2001) (holding that the measure of damages for an option's breach "is the traditional one: 'the difference between the price contracted to be paid and the value of the article when it should [have been] delivered'" (quoting Randon v. Barton, 4 Tex. 289, 293 (1849))).

offered) by the third party.[292]

Special or consequential damages repay losses that follow naturally, but not necessarily, from the breach and, therefore, are recoverable only if the breaching party had notice or could have foreseen that the non-breaching party would suffer the loss from the contract's breach.[293] Such damages include lost profits from the burdened property's use[294] and increased financing costs.[295]

Moreover, a holder's ability to recover direct or special damages is governed by the rule that:

> [A]n option holder 'need not tender performance of the contract, but he must plead and prove that he was ready, willing, and able to perform in order to recover damages.'
>
> Courts often apply this rule to bar recovery to option holders who cannot prove that they had the financial ability to pay for the subject property at the time of the owner's breach. Likewise, an option holder who is not 'willing to perform'—one who simply would have declined to exercise his option—suffers no legal damage from breach of the option contract.[296]

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[292] Atchison v. City of Englewood, 568 P.2d 13, 22 (Colo. 1977); Anderson v. Armour & Co., 473 P.2d 84, 89 (Kan. 1970); Arlington State Bank v. Colvin, 545 N.E.2d 572, 575 (Ind. Ct. App. 1989). Because the third party often pays the market price for the burdened property, the holder may have no benefit of the bargain damages. In such an event, the holder may seek to recover its out-of-pocket loss of funds or reliance damages. *E.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 347, 349, 356 (1981); 2 William V. Dorsaneo III, *Texas Litigation Guide* § 21.02[2], at 21–27 (2008); 2 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 64.1, 64.2 (4th ed. 2003).

[293] *E.g.*, *Baylor*, 221 S.W.3d at 636; *Arthur Andersen*, 945 S.W.2d at 817.

[294] *See* Simulnet E. Assocs. v. Ramada Hotel Operating Co., Nos. 95-16339 & 95-16340, 1997 U.S. App. LEXIS 41152, at *13–15 (9th Cir. July 31, 1997) (applying Nevada law) (affirming a judgment awarding the holder lost profits for its first-refusal right's breach); Shell v. Austin Rehearsal Complex, Inc., No. 03-97-0411-CV, 1998 WL 476728, at *11 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication) (awarding lost profits from the property's use); *see also* Ryan v. Thurmond, 481 S.W.2d 199, 206 (Tex. Civ. App.—Corpus Christi 1972, writ ref'd n.r.e.) (awarding damages for loss of the fair rental value of a building to be constructed).

[295] *E.g.*, Paciwest, Inc. v. Warner Alan Props., 266 S.W.3d 559, 574–75 (Tex. App.—Fort Worth 2008, no pet.).

[296] *Koch*, 918 F.2d at 1214 (quoting Olson v. Bayland Pub., Inc., 781 S.W.2d 659, 664 (Tex.

In addition, to its contract action, a holder also may have a cause of action against the third party for tortious interference with contract, if the third party induced the grantor to breach the first-refusal right by not giving notice of, or by giving a misleading or defective one about, the third party's offer to the holder.[297] Of course, in such a case, the third party, in addition to direct and special damages, also may be liable for exemplary damages.[298]

Finally, not only a grantor or third party may have liability to a holder, a grantor or holder also may have liability to a third party. For example, in *Abraham Investment Co. v. Payne Ranch, Inc.*, the plaintiff was a jilted third party cash purchaser of property burdened by a first-refusal right who was deprived of the purchase when the holder exercised the right, agreeing to match the plaintiff's all cash price and other terms and conditions.[299] After exercising the right, the holder successfully negotiated with the grantor for "seller financing," and the third party sued the grantor and the holder for specific performance,[300] and the holder for, among other things, tortious interference with its purchase contract.[301]

In affirming a partial summary judgment granting the third party specific performance of its purchase contract with the grantor, the Seventh

App.—Houston [1st Dist.] 1989, writ denied) (citations omitted)); *see also* Amerada Hess Corp. v. Schwartz, No. 14-93-0157-CV, 1995 Tex. App. LEXIS 1819, at *5 (Tex. App.—Houston [14th Dist.] Aug. 10, 1995, no writ).

[297] *See* Kjesbo v. Ricks, 517 N.W.2d 585, 590–91 (Minn. 1994); Praxair, Inc. v. Airgas, Inc., No. 98-CVS-8571, 1999 NCBC LEXIS 9, at *19–21 (N.C. Super. Ct. Oct. 20, 1999). To the extent that *West Texas Transmission's* good-faith requirement applies under Texas law, a third party, who induces the grantor to include a commercially unreasonable or bad-faith term or condition in the third party's contract conceivably could be liable to the holder for tortious interference. *E.g.*, David A. Bramble, Inc. v. Thomas, 914 A.2d 136, 147 (Md. 2007) ("In some cases, there have been arguments made that the third party, for its own conduct [in connection with the breach of a good-faith requirement], should be liable for intentional interference with the preemptioner's right of first refusal." (citing Prince v. Elm Inv. Co., 649 P.2d 820, 821 (Utah 1982))).

[298] *Compare* Seelbach v. Clubb, 7 S.W.3d 749, 756–57 (Tex. App.—Texarkana 1999, pet. denied) (holding that exemplary damages are recoverable for tortious interference with contract), *and* Armandariz v. Mora, 553 S.W.2d 400, 407 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.) (same), *with* Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986) (holding that exemplary damages are not recoverable in a contract action even if the breach was intentional or malicious), *and* RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981) (concluding that exemplary damages are not recoverable for a contract breach).

[299] 968 S.W.2d 518, 522–23 (Tex. App.—Amarillo 1998, no writ).

[300] *Id.*

[301] *Id.*

Court of Appeals relied on the fact that the contract required the holder to match its terms exactly.[302] The court also remanded the tortious interference claim to the district court for further proceedings.[303]

VIII. THE GRANTOR AND THIRD PARTY'S AFFIRMATIVE DEFENSES

A grantor or third party has two basic types of defenses to claims asserted by a holder for a first-refusal right's breach. The first type relates to the right's validity, and includes the statute of frauds and the rules against perpetuities and unreasonable restraints on alienation.[304] The second type consists of traditional contract affirmative defenses such as waiver, estoppel, laches, and limitations. Both types are discussed below.

A. The Statute of Frauds

First-refusal rights relating to real-estate transactions,[305] including real property leases for more than a year[306] and contracts to assign or transfer oil, gas, or mineral interests,[307] or the sale of goods for more than $500[308]

[302] *Id.* at 524, 527.

[303] *Id.* at 528. *See also* LDC-728 Milwaukee, L.L.C. v. Raettig, 727 N.W.2d 82, 86–87 (Wis. Ct. App. 2006) (holding that the holder breached a first-refusal right when he exercised it knowing that he could not purchase the burdened property). The grantor and holder are most at risk if the grantor's contract with the third party is conditioned on the holder's purchase on terms identical to those in the third party's contract.

[304] Another ground on which a first-refusal right's validity can be attacked is lack of consideration. *E.g.*, Serenic Software, Inc. v. Protean Techs., Inc., No. CV-04-415-LMB, 2007 WL 1366547, at *12 (D. Idaho 2007) (applying Idaho law) (unreported mem. op.) ("[T]he alleged right of first-refusal agreement must fail for lack of consideration.").

[305] Tex. Bus. & Com. Code Ann. § 26.01(b)(4) (Vernon 2009); Tex. Prop. Code Ann. § 5.072(a) (Vernon 2004); Reiland v. Patrick Thomas Props., Inc., 213 S.W.3d 431, 436–37 (Tex. App.—Houston [1st Dist.] 2006, no pet.); *see also* Rolfe v. King, No. 05-03-00357-CV, 2004 WL 784626, at *2 (Tex. App.—Dallas Mar. 29, 2004, no pet.) (unreported mem. op.); Foster v. Bullard, 496 S.W.2d 724, 733 (Tex. Civ. App.—Austin 1973, writ ref'd n.r.e.); Cherry v. Salinas, 355 S.W.2d 833, 834 (Tex. Civ. App.—San Antonio 1962, writ ref'd n.r.e.); *cf.* Watkins v. Arnold, 60 S.W.2d 476, 477 (Tex. Civ. App—Texarkana 1933, writ ref'd) (holding that option contracts relating to land are within the statute of frauds).

[306] *E.g.*, Tex. Bus. & Com. Code Ann. § 26.01(b)(5); Tex. Prop. Code Ann. § 5.021; 2616 S. Loop L.L.C. v. Health Source Home Care, Inc., 201 S.W.3d 349, 355 (Tex. App.—Houston [14th Dist.] 2006, no. pet.).

[307] Quigley v. Bennett, 227 S.W.3d 51, 54 (Tex. 2007) (involving royalty interest); Long Trusts v. Griffin, 222 S.W.3d 412, 416 (Tex. 2006) (involving assignment of oil and gas interests).

[308] Tex. Bus. Com. Code Ann. § 2.201(a); E. Hill Marine, Inc. v. Rinker Boat Co., 229

must satisfy the statute of frauds.[309] A first-refusal right that violates the statute of frauds, however, is not void. It merely is voidable.[310]

To satisfy the statute, the right must be in a writing signed by the grantor[311] (or his agent or legal representative)[312] that: (1) shows a binding agreement;[313] (2) identifies the parties;[314] and (3) identifies the right's subject matter.[315] Thus, for example, if the right does not describe the burdened property sufficiently, it is voidable and will not support an action for specific performance or damages for breach of contract.[316] As held by the First Court of Appeals: "The well settled rule to test the sufficiency of a description in a deed is that 'the writing must furnish within itself or by reference to some other existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty.'"[317]

S.W.3d 813, 818 (Tex. App.—Fort Worth 2007, no pet.). The Texas Uniform Commercial Code defines "goods:"

> [A]ll things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action. 'Goods' also includes the unborn young of animals and growing crops and other identified things attached to realty . . . ."

Tex. Bus. & Com. Code § 2.105(a).

[309] The grantor or third party must plead the statute of frauds as an affirmative defense. Tex. R. Civ. P. 94; First Nat'l Bank v. Zimmerman, 442 S.W.2d 674, 677 (Tex. 1969); Santa Fe Petroleum, L.L.C. v. Star Canyon Corp., 156 S.W.3d 630, 641 (Tex. App.—Tyler 2004, no pet.).

[310] *E.g.*, Troxel v. Bishop, 201 S.W.3d 290, 300 (Tex. App.—Dallas 2006, no pet.); Enochs v. Brown, 872 S.W.2d 312, 318 (Tex. App.—Austin 1994, no writ).

[311] Tex. Bus. & Com. Code Ann. § 26.01(a)(1).

[312] *Id.* § 26.01(a)(2).

[313] *E.g.*, Haase v. Glazner, 62 S.W.3d 795, 798 (Tex. 2001).

[314] *E.g.*, BACM 2001-1 San Felipe Rd. L.P. v. Trafalgar Holdings 1, Ltd., 218 S.W.3d 137, 144 (Tex. App.—Houston [14th Dist.] 2007, no pet.); Dobson v. Metro Label Corp., 786 S.W.2d 63, 65 (Tex. App.—Dallas 1990, no writ).

[315] Tex. Bus. & Com. Code Ann. § 26.01(b)(4) (writing requirement for "a contract for the sale of real estate"); Tex. Prop. Code Ann. § 5.021 (Vernon 2004) (writing requirement for property contracts); Rolfe v. King, No. 05-03-00357-CV, 2004 WL 784626, at *2 (Tex. App.—Dallas Mar. 29, 2004, no pet.) (mem. op.); Garner v. Redeaux, 678 S.W.2d 124, 126 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.).

[316] *See, e.g.*, Reiland v. Patrick Thomas Props., Inc., 213 S.W.3d 431, 437–38 (Tex. App.—Houston [1st Dist.] 2006, no pet.) (mem. op.) (holding a first-refusal right void under the statute because it contained an inadequate land description); Dunlop-Swain Tire Co. v. Simons, 450 S.W.2d 378, 380–81 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.) (same).

[317] *Reiland*, 213 S.W.3d at 436 (quoting Morrow v. Shotwell, 477 S.W.2d 538, 539 (Tex. 1972)).

Because the statute of frauds requires the writing to contain the contract's essential terms, grantors and third parties on occasion have argued that the typical first-refusal right in which the price is based on a bona fide, third-party offer renders the contract partly in parol and unenforceable under the statute.[318] This argument, however, has been uniformly rejected because of the general rule that the statute is satisfied if the writing prescribes a method by which the purchase price can be determined.[319] In fact, most courts will enforce a first-refusal right even when the right contains no price or price mechanism, holding that the third party's bona fide offer sets the price and terms and conditions that the holder must accept to exercise the right.[320]

B. The Rule Against Unreasonable Restraints on Alienation

Alienation is a legal incident of property,[321] and unreasonable restraints against it are contrary to public policy and generally unenforceable.[322]

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[318] *See* Brenner v. Duncan, 27 N.W.2d 320, 321 (Mich. 1947); Barling v. Horn, 296 S.W.2d 94, 96–97 (Mo. 1956).

[319] *E.g.*, Steinberg v. Sachs, 837 So. 2d 503, 505–06 (Fla. Dist. Ct. App. 2003); *Brenner*, 27 N.W.2d at 322; *Barling*, 296 S.W.2d at 97; Albright, *supra* note19, at 806.

[320] *E.g.*, Radio WEBS, Inc. v. Tele-Media Corp. 292 S.E.2d 712, 713 n.2 (Ga. 1982) ("Where no price is stated when the right is granted, the offer of the third party supplies the terms under which the right of first refusal may be exercised."); Brownies Creek Collieries, Inc. v. Asher Coal Mining Co., 417 S.W.2d 249, 252 (Ky. 1967) ("A contract provision giving simply the 'right of first refusal' . . . without qualifying terms means . . . that the holder has the right to elect to take the property on the same price and on the same terms and conditions as those of an offer by a third party that the owner is willing to accept."); Peet v. Randolph, 33 S.W.3d 614, 618 (Mo. Ct. App. 2000) ("[M]issing terms such as the price of the land or the duration do not render [a first-refusal] clause unenforceable."); CORBIN, *supra* note 1, § 11.3, at 482–83 (same); 6 *American Law of Property* § 26.65, at 507 (1952) ("If no price is specified in the [first-refusal right,] the natural interpretation is that the offeror's price must be paid upon exercise of the pre-emption."). *But see* Duke v. Whatley, 580 So. 2d 1267, 1274–75 (Miss. 1991) (affirming trial court's denial of specific performance because first-refusal did not specifically provide a mechanism for determining holder's purchase price); Hood v. Hawkins, 478 A.2d 181, 186–87 (R.I. 1984) (same); Rolfs v. Mason, 119 S.E.2d 238, 242 (Va. 1961) (same).

[321] Potter v. Couch, 141 U.S. 296, 315 (1891) (holding that "the right of alienation is an inherent and inseparable quality of an estate in fee simple").

[322] *E.g.*, Procter v. Foxmeyer Drug Co., 884 S.W.2d 853, 859 (Tex. App.—Dallas 1994, no writ). Texas courts look to the three Restatements on Property to determine whether an alleged restraint on alienation is unreasonable and, therefore, unenforceable. *E.g.*, Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 537 (Tex. App.—Waco 2008, pet. denied) (citing cases). Section 404 of the Restatement of Property defines a restraint on alienation, in part:

First-refusal rights undeniably restrict alienability to some extent: the grantor is deprived of freedom to convey the burdened property to whomever it pleases.[323]

In Texas, as in most other jurisdictions, the typical first-refusal right (which requires the holder to match the terms and conditions of a third party's bona fide offer) is considered a reasonable alienation restraint:[324]

> [The first-refusal right] involved here does not constitute an unreasonable restraint on alienation. There is no fixed price. There is no absolute option unlimited as to time. There is only the right, exercisable whenever the owner desires to sell, to purchase the property by meeting any bona fide offer. The holder of the right cannot force or prevent a sale; neither can he fix the price for a sale. In those circumstances there is not such a restraint on alienation as would violate our public policy. [325]

On the other hand, a fixed-price, first-refusal right of unlimited or long duration likely will be held to be an unreasonable restraint on alienation and void.[326]

> [A]n attempt by an otherwise effective conveyance or contract to cause a later conveyance . . . to impose contractual liability on the one who makes the later conveyance when such liability results from a breach of an agreement not to convey; or . . . to terminate or subject to termination all or part of the property interest conveyed.

RESTATEMENT OF PROP. §§ 404(1)(b)–(c) (1944) (quoted with approval in *Navasota*, 249 S.W.3d at 537–38).

[323] Albright, *supra* note 19, at 807.

[324] *Procter*, 884 S.W.2d at 859 ("[A] right of first refusal is not a restraint on alienation if the terms of the right are reasonable.").

[325] Forderhause v. Cherokee Water Co., 623 S.W.2d 435, 439 (Tex. Civ. App.—Texarkana 1981), *rev'd on other grounds*, 641 S.W.2d 522, 525 (Tex. 1982); *accord Navasota*, 249 S.W.3d at 538; Perritt Co. v. Mitchell, 663 S.W.2d 696, 698–99 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.); Sibley v. Hill, 331 S.W.2d 227, 229 (Tex. Civ. App.—El Paso 1960, no writ); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. f (2000); RESTATEMENT (SECOND) OF PROP. § 4.4 (1983); RESTATEMENT OF PROP. § 413 cmt. 3 (1944); CORBIN, *supra* note 1 § 11.3, at 484–45; Albright, *supra* note 19, at 807; Reasoner, *supra* note 19, at 60–65.

One Texas case, *Gray v. Vandver*, 623 S.W.2d 172, 174 (Tex. App.—Waco 1981, writ denied), without considering the many other Texas and non-Texas cases to the contrary, incorrectly held that a non-fixed-price, first-refusal right constituted an unreasonable restraint on alienation.

[326] Iglehart v. Phillips, 383 So. 2d 610, 615–16 (Fla. 1980) (holding a fixed-price, first-refusal

C. The Rule Against Perpetuities

The Texas Constitution prohibits perpetuities.[327] The rule against perpetuities requires that an estate or interest is valid only if vests, if at all, within the period of some life in being at the effective date of the instrument creating the future interest or twenty-one years thereafter plus a period of gestation.[328]

The Texas Supreme Court has held that the typical first-refusal right (which requires the holder to match the terms and conditions of a bona fide, third-party offer), even if unlimited in duration, does not violate the rule.[329] The Fifth Circuit most clearly explained this in *Weber v. Texas Co.*:

> The rule against perpetuities springs from considerations of public policy. The underlying reason for and purpose of the rule is to avoid fettering real property with future interests dependent upon contingencies unduly remote which isolate the property and exclude it from commerce and development for long periods of time, thus

right of unlimited duration void as an unreasonable restraint on alienation); Edgar v. Hunt, 706 P.2d 120, 122 (Mont. 1985) (holding that a fixed-priced, first-refusal right may be invalid if the price becomes disproportionate to the burdened property's market value); *see* Mo. State Highway Comm'n v. Stone, 311 S.W.2d 588, 590 (Mo. Ct. App. 1958) (same); Metro. Transp. Auth. v. Bruken Realty Corp., 492 N.E.2d 379, 385 (N.Y. 1986) (noting that a fixed-price, first-refusal right is a "far more serious interference with alienability" than an ordinary one); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. f (2000) ("If the price at which the right of first refusal may be exercised is fixed, either absolutely, or by reference to a formula, the impact on alienability is greater than if the seller will get the same price whether or not the right is exercised. Stronger justification is required. The duration of such a restraint may be important in determining its reasonableness."); Albright, *supra* note 19, at 808 ("A preferential right provision with more restrictive conditions, such as requiring a sale at a specified price, which may be far less than market value, or placing restrictions on prospective purchasers, will probably be held void.").

[327] Tex. Const. art. I, § 26 ("Perpetuities . . . are contrary to the genius of a free government and should never be allowed . . . ."); *accord Forderhause*, 623 S.W.2d at 438.

[328] Kettler v. Atkinson, 383 S.W.2d 557, 561 (Tex. 1964); Brooker v. Brooker, 130 Tex. 27, 38–39, 106 S.W.2d 247, 254 (1937); Albright, *supra* note 19, at 808–09.

[329] *Forderhause*, 623 S.W.2d at 439; *accord* Weber v. Tex. Co., 83 F.2d 807, 808 (5th Cir. 1936) (applying Texas law); *Perritt*, 663 S.W.2d at 698–99; Foster v. Bullard, 496 S.W.2d 724, 735 (Tex. Civ. App.—Amarillo 1973, writ ref'd n.r.e.); Courseview, Inc. v. Phillips Petroleum Co., 258 S.W.2d 391, 393 (Tex. Civ. App.—Galveston, 1953, writ ref'd n.r.e.); *see* Murphy Exploration & Prod. Co. v. Sun Operating L.P., 747 So. 2d 260, 263 (Miss. 1999) (following Texas law and noting that Texas courts consistently have held that a non-fixed-price, first-refusal right does not violate the rule against perpetuities).

> working an indirect restraint upon alienation, which is regarded at common law as a public evil.
>
> The [first-refusal right] under consideration is within neither the purpose of nor the reason for the rule. This is not an exclusive option to the lessee to buy at a fixed price which may be exercised at some remote time beyond the limit of the rule against perpetuities, meanwhile forestalling alienation. The [first-refusal right] simply gives the lessee the prior right to take the lessor's royalty interest at the same price the lessor could secure from another purchaser whenever the lessor desires to sell. It amounts to no more than a continuing and preferred right to buy at the market price whenever the lessor desires to sell. This does not restrain free alienation by the lessor. He may sell at any time, but must afford the lessee the prior right to buy. The lessee cannot prevent a sale. His sole right is to accept or reject as a preferred purchaser when the lessor is ready to sell. The [right of first refusal] is therefore not objectionable as a perpetuity.[330]

D. Affirmative Defenses

Because first-refusal rights are contract rights, a grantor or third party sued for specific performance has the same defenses that any alleged breaching party sued for specific performance has, including laches,[331]

[330] *Weber*, 83 F.2d at 808. Most other jurisdictions also hold that the rule against perpetuities does not apply to non-fixed-price, first-refusal rights. *See* CORBIN, *supra* note 1, § 11.03, at 484–85. Additionally, the Third Restatement of Property, rejecting the Second Restatement's position, exempts the typical first-refusal right from the rule. *Compare* RESTATEMENT (THIRD) OF PROP. SERVITUDES § 3.3 cmt. a (2000) (noting that the rule against perpetuities does not apply to first-refusal rights), *with* RESTATEMENT (SECOND) OF PROP. § 4.4 cmt. c (1983) (noting that first-refusal rights are subject to the rule against perpetuities).

[331] *E.g.*, Henderson v. Millis, 373 N.W.2d 497, 505 (Iowa 1985); *Bullard*, 496 S.W.2d at 736–37; Hartnett v. Jones, 629 P.2d 1357, 1364 (Wyo. 1981). Ordinarily, laches is not available when a suit for specific performance has been filed within the four-year limitations period. *E.g.*, Bilotto v. Brown, No. 04-96-00055-CV, 1996 WL 591926, at *2 (Tex. App.—San Antonio Oct. 9, 1996, no writ) (not designated for publication) ("[I]f suit is brought within the statute of limitations, laches will not apply in the absence of estoppel or extraordinary circumstances."); Helsley v. Anderson, 519 S.W.2d 130, 133–34 (Tex. App.—Dallas 1975, no writ) ("[W]hen an alleged cause of action, either legal or equitable comes within any of the specific provisions of the

limitations,[332] unclean hands,[333] waiver,[334] and estoppel.[335] A grantor who is sued for damages for a first-refusal right's breach has the same affirmative defenses that any allegedly breaching contracting party has, including limitations,[336] waiver,[337] and estoppel.[338]

As a first-refusal right is not triggered until the holder receives notice of the third-party offer, a question exists regarding whether the statute of limitations is tolled until the holder learns about a transaction in violation of the right—that is, whether the discovery rule applies to specific

statute of limitations, the equitable defense of laches is inapplicable unless extraordinary circumstances exist . . . ."); Richards v. Combest, 208 S.W.2d 392, 405 (Tex. Civ. App.—Beaumont 1947, writ ref'd n.r.e.) (holding that mere delay by heirs in filing specific performance suit did not bar action filed within four years of the decedent's death).

[332] Ordinarily, an action for specific performance of an oral or written contract must be commenced within four years after the cause of action has accrued. Tex. Civ. Prac. & Rem. Code Ann. §§ 16.004, 16.051 (Vernon 2008); Tex. Bus. & Com. Code Ann. § 2.275 (Vernon 2009) (relating to sale of "goods" under the Uniform Commercial Code); Long Trusts v. Griffin, 144 S.W.3d 99, 104 (Tex. App.—Texarkana 2004), *aff'd and rev'd in part on other grounds*, 222 S.W.3d 412, 416 (Tex. 2006); *Helsley*, 519 S.W.2d at 134.

[333] *See* Maharishi Sch. of Vedic Sci. v. Olympus Real Estate Corp., No. 05-01-00140-CV, 2002 WL 1263894, at *2 (Tex. App.—Dallas June 7, 2002, pet. denied) (not designated for publication) (holding that a party who seeks specific performance must come into court with clean hands); Gordin v. Shuler, 704 S.W.2d 403, 408 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (same); Steves v. United Servs. Auto. Ass'n, 459 S.W.2d 930, 933 (Tex. Civ. App.—Beaumont 1970, writ ref'd n.r.e.) (same).

[334] *E.g.*, Sel-Lab Mktg., Inc. v. Dial Corp., No. 01 Civ.-9250(SHS), 2002 WL 1974056, at *3 (S.D.N.Y. Aug. 27, 2002) (unreported op.) (applying New York law); A.G.E., Inc. v. Buford, 105 S.W.3d 667, 673–74 (Tex. App.—Austin 2003, no pet.); Ellis v. Waldrop, 627 S.W.2d 791, 795–96 (Tex. App.—Fort Worth 1982, writ granted); *see Henderson*, 373 N.W.2d at 504–05; 2 Dorsaneo, *supra* note 292, § 51.03[4][b] (pointing out that waiver is a defense to specific performance).

[335] *E.g.*, *Henderson*, 373 N.W.2d at 504–05 (estoppel); Foster v. Hanni, 841 P.2d 164, 171 (Alaska 1992) (estoppel); Mulvey v. Mobil Producing Tex. & N.M., Inc., 147 S.W.3d 594, 607 (Tex. App.—Corpus Christi 2004, no pet.) (quasi-estoppel); Pearson v. Schubach, 763 P.2d 834, 836 (Wash. Ct. App. 1988) (estoppel); *see* 2 Dorsaneo, *supra* note 292, § 51.03[4][b] (pointing out that estoppel is a defense to specific performance).

[336] Because a first-refusal right is contractual, the four-year limitations period of Section 16.004 of the Texas Civil Practice & Remedies Code relating to "debts" applies. *See, e.g.*, Elledge v. Friberg-Cooper Water Supply Corp., 240 S.W.3d 869, 870 (Tex. 2007) (holding that breach of contract actions fall within Section 16.004). Of course, if the right relates to "goods" within the meaning of the UCC, the UCC's four-year limitations period governs the claim. *See* Tex. Bus. & Com. Code Ann. § 2.725 (Vernon 2009).

[337] *E.g.*, *A.G.E.*, 105 S.W.3d at 673–74; *Ellis*, 627 S.W.2d at 795–96.

[338] *E.g.*, *Hanni*, 841 P.2d at 170–71; *Pearson*, 763 P.2d at 836.

performance or damage claims arising from the right's breach.[339] Although no Texas case has considered the question of whether the discovery rule applies to such claims, for the reasons discussed below, it clearly does not.

Accrual refers to when a limitations period begins to run.[340] Because no statute defines when a contract action accrues, a court must look to the legal-injury rule.[341] Under that rule, a cause of action generally accrues when a wrongful act causes some legal injury, regardless of when the plaintiff learns of the injury and even if all resulting damages have not yet occurred.[342] A legal injury consists of any invasion of plaintiff's legally protected interests.[343] Stated another way, a cause of action generally accrues when facts come into existence authorizing a claimant to seek a judicial remedy.[344] When the defendant's conduct produces a legal injury, however slight, the cause of action accrues and the statute of limitations begins to run.[345]

The statute of limitations for a contract claim—irrespective of whether the remedy sought is specific performance or damages—is four years from the date of accrual.[346] Unless the discovery rule applies, a contract claim—whether for damages or specific performance—accrues immediately upon breach.[347] A contract breach occurs when a party fails or refuses to do something that it promised to do in the contract.[348]

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[339] The triggering of first-refusal rights is discussed *supra* Part III.

[340] *E.g.*, Seureau v. ExxonMobil Corp., 274 S.W.3d 206, 226 (Tex. App.—Houston [14th Dist.] 2008, no pet.); XCO Prod. Co. v. Jamison, 194 S.W.3d 622, 634 (Tex. App.—Houston [14th Dist.] 2006, no pet.). An action's accrual date is a question of law for the court. Moreno v. Sterling Drug, Inc., 787 S.W.2d 348, 351 (Tex. 1990).

[341] S.V. v. R.V., 933 S.W.2d 1, 4 (Tex. 1996); *Seureau*, 274 S.W.3d at 226.

[342] *S.V.*, 933 S.W.2d at 4; *see* Robert K. Wise et al., *Negligent Misrepresentation in Texas: The Misunderstood Tort*, 40 TEX. TECH L. REV. 845, 909 (2008) (discussing limitations in general).

[343] Goggin v. Grimes, 969 S.W.2d 135, 137 (Tex. App.—Houston [14th Dist.] 1998, no pet.).

[344] Trail Enters., Inc. v. City of Houston, 957 S.W.2d 625, 631 (Tex. App.—Houston [14th Dist.] 1997, no pet.).

[345] Childs v. Haussecker, 974 S.W.2d 31, 41 n.7 (Tex. 1998); *Goggin*, 969 S.W.2d at 137.

[346] Tex. Civ. Prac. & Rem. Code Ann. § 16.004(a)(1)–(3) (Vernon 2002); Via Net v. TIG Ins. Co., 211 S.W.3d 310, 314 (Tex. 2006); Stine v. Stewart, 80 S.W.3d 586, 592 (Tex. 2002). *See also* authorities cited *supra* notes 333 and 337.

[347] Barker v. Eckman, 213 S.W.3d 306, 311 (Tex. 2006); *Stine*, 80 S.W.3d at 592; Seureau v. ExxonMobil Corp., 274 S.W.3d 206, 227 (Tex. App.—Houston [14th Dist.] 2008, no pet.).

[348] *Seureau*, 274 S.W.3d at 227; Townewest Homeowners Ass'n v. Warner Commc'n Inc., 826 S.W.2d 638, 640 (Tex. App.—Houston [14th Dist.] 1992, no writ).

The discovery rule is a limited exception to the general accrual rule.[349] Under the rule, the statute of limitations is tolled until the plaintiff knows or, in the exercise of reasonable diligence, should have known, about the wrongful act and resulting injury.[350] It applies in cases of fraud and fraudulent concealment[351] and in other cases in which "the injury's nature is inherently undiscoverable and evidence of the injury is objectively verifiable"[352] Because the discovery rule applies categorically to "bring[] predictability and consistency to the jurisprudence,"[353] "the focus is on whether a particular type of injury, rather than the plaintiff's specific injury, is discoverable."[354]

The discovery rule rarely applies to contract claims "as diligent contracting parties should generally discover any breach during the relatively long four year limitations period provided for such claims[,]"[355] and it is difficult to fathom how a breach of a first-refusal right can be inherently undiscoverable because the holder always can ask the grantor if

[349] *E.g.*, Achee v. Port Drum Co., 197 F. Supp. 2d 723, 731 (E.D. Tex. 2002) (applying Texas law); Computer Assocs. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 455 (Tex. 1996); Wise, *supra* note 342, at 910.

[350] Sunpoint Sec., Inc. v. Chesier & Fuller, L.L.P. (*In re* Sunpoint Sec., Inc.), 377 B.R. 513, 552 (Bankr. E.D. Tex. 2007) (applying Texas law); Murphy v. Campbell, 964 S.W.2d 265, 270 (Tex. 1997).

[351] *See* Berkley v. Am. Cyanamid Co., 799 F.2d 995, 998 (5th Cir. 1986) (applying Texas law); *Computer Assocs.*, 918 S.W.2d at 455; *Seureau*, 274 S.W.3d at 227–28; Wise, *supra* note 342, at 910.

[352] *Computer Assocs.*, 918 S.W.2d at 456; *accord* HECI Exploration Co. v. Neel, 982 S.W.2d 881, 886 (Tex. 1998); Wise, *supra* note 342, at 910. An injury "is inherently undiscoverable if it is by its nature unlikely to be discovered within the applicable limitations period despite the exercise of due diligence." S.V. v. R.V., 933 S.W.2d 1, 7 (Tex. 1996); *accord* Wagner & Brown, Ltd. v. Horwood, 58 S.W.3d 732, 734 (Tex. 2001); Wise, *supra* note 342, at 910. To be inherently undiscoverable the injury need not be impossible to discover. *S.V.*, 933 S.W.2d at 7; Wise, *supra* note 342, at 910. Rather, when determining whether an injury is inherently undiscoverable, a court considers the circumstances surrounding the injury, the degree, of the plaintiff's diligence, and the injury's nature. *S.V.*, 933 S.W.2d at 7; Wise, *supra* note 342, at 910. An injury is objectively verifiable if its presence and the wrongful act causing it cannot be disputed, and physical or other evidence exists to corroborate the claim's existence. *Achee*, 197 F. Supp. 2d at 731; *see also S.V.*, 933 S.W.2d at 4; Wise, *supra* note 342, at 910.

[353] Apex Towing Co. v. Tolin, 41 S.W.3d 118, 122 (Tex. 2001); *accord Seureau*, 274 S.W.3d at 228; *see also HECI Exploration*, 982 S.W.2d at 886; Wise, *supra* note 342, at 910.

[354] Via Net v. TIG Ins. Co., 211 S.W.3d 310, 314 (Tex. 2006); *Seureau*, 274 S.W.3d at 228–29.

[355] *Seureau*, 274 S.W.3d at 229 (citing to *Via Net*, 211 S.W.3d at 314–15).

the grantor is in compliance with the right, and because most real property transactions—the type of transactions in which most first-refusal rights are granted—are recorded.[356] As recently noted by the Fourteenth Court of Appeals:

> [D]ue diligence requires that each contracting party protect its own interests. The exercise of due diligence may require that a party ask its contract partner for information needed to verify the other's contractual performance. One who, as here, fails to ask for such information has not used due diligence. It is for this reason that the Texas Supreme Court [in *Via Net v. TIG Insurance Co.*[357]] has expressed concern about the use of the discovery rule in contract actions . . . .[358]

IX. RECOMMENDATIONS FOR DRAFTING AND EXERCISING FIRST-REFUSAL RIGHTS

This Article sets forth default rules relating to the construction of first-refusal rights and their exercise. Because such rights are contract rights, the parties can draft around them. Set forth below are recommendations for drafting and exercising a first-refusal right so as to minimize the potential for litigation.

A. The First-Refusal Right's Triggering

- Avoid triggering the right by the grantor's subjective state of mind. The first-refusal right should identify specifically when and under what circumstances it may be exercised because much litigation centers on whether the right has been triggered. As discussed above, a first-refusal right does not grant the holder an unconditional right to purchase the property, but rather is triggered by the grantor's decision to part with the property.[359] Although this principle is stated easily in the abstract, reducing it to effective contractual language is difficult. The first-refusal right should not, as many do, say that

[356] First-refusal rights in real property transactions are discussed in Part VIII.A.

[357] 211 S.W.3d at 314.

[358] *Seureau*, 274 S.W.3d at 229 (citations omitted).

[359] *See* discussion *supra* notes 5 and 48–50.

the right is triggered when the grantor "desires" to sell the property or words of similar effect (e.g., decides, elects, or intends) because defining the trigger in terms of the grantor's subjective decision invites disputes about whether the grantor "decided" to sell. Nor should the right be triggered by the owner's receipt of an acceptable bona fide offer for the property. Although this standard is perhaps more objective, it also leads to disputes regarding the grantor's state of mind, as well as to disputes regarding the offer's bona fides. To avoid these difficulties, the first-refusal right's trigger clause should prevent litigation about the grantor's state of mind, particularly when the burdened property has not, in fact, been sold. At the same time, it also must ensure that the holder has an adequate opportunity to exercise its right before the owner sells. As a solution, the right's triggering clause might provide that: "The grantor may not sell the burdened property to a person other than the holder without first giving written notice to the holder [a specified number of days] before such sale will occur unless the holder exercises its first-refusal right within [a specified number of days] after its receipt of the notice."

- Specifically address whether the right is triggered by involuntary transfers, transfers by gift, operation of law, mergers, transfers to affiliates, and changes in corporate ownership or control. Too often, drafters simply list a combination of legal nouns (e.g., sale, conveyance, assignment, exchange, or transfer) to describe the transactions triggering the first-refusal right. This leads to disputes regarding whether the right is triggered by the burdened property's gift, involuntary sale, transfer by operation of law, or transfer to the grantor's affiliate or owner or by the by a corporate grantor's merger or change in control.[360] One way to minimize disputes is to state expressly in the first-refusal right what types of transfers and conveyances trigger it. For example, the right can provide that the right is or is not triggered by the burdened property's gift, involuntary transfer, or transfer by operation of law, to an affiliate, by a corporate grantor's merger, or by a change in

[360] See *supra* Part III.B.

control of a corporate grantor. In fact, the right even can address changes in corporate management by providing that the right is triggered by a change in a corporate-grantor's key personnel, such as its chief executive officer or chief financial officer.

- Specifically address the holder's rights in the event the burdened property is sold as part of a larger property or as part of a package of properties. When the first-refusal right relates to property that can be sold as part of a larger property or with other properties, the right should cover such possibilities by stating whether it is triggered by such a transaction and how the purchase price will be allocated to the burdened property. For example, the right might provide that a package deal does not trigger the right or that, if triggered, the purchase price for the burdened property will be its fair market value as determined by an appraisal process.

B. Notice

- Specifically state what is required in the notice to the holder and how the holder is to exercise the right after notice. The first-refusal right should delineate how the notice is to be provided and the information that must be in the notice. One useful practice is to require the grantor to identify the prospective purchaser and to send the holder a copy of the proposed contract or third-party offer. The holder should then promptly identify needed information, specifically and in writing, and the grantor should respond in writing promptly. Both parties should keep a record of all requests and responses.

C. Exercise and Termination

- Deal with the possibility of non-cash consideration. As discussed above, the third-party offer may provide for unique consideration, such as a land, a partnership interest, or a rare painting or involve financing terms or a guarantee. To avoid a matching controversy, the first-refusal right should cover such possibilities. For example, it might provide that it is triggered only by an all cash offer. Alternatively, it can provide that in

the event of an asset exchange or other noncash consideration, the holder has the right to pay an equivalent amount of cash determined by an appraisal mechanism.

- Specifically state whether the grantor can retract or modify the notice before the holder exercises it. As discussed above, disputes can arise if the grantor attempts to retract or modify the notice before the holder exercises it. The first-refusal right should specify whether the grantor can retract or modify the notice if the third party's offer terminates or is modified.

X. ALTERNATIVES TO FIRST-REFUSAL RIGHTS

The first-refusal right is a means of dealing with foreseeable, but generally indeterminate changes, in business relationships. Alternatives to a first-refusal right include the option,[361] the right of first offer, a commitment to negotiate, and a commitment to auction. These alternatives often are preferable to a first-refusal right.

A. The Right of First Offer

The first-offer right is essentially a reverse first-refusal right. Its use is demonstrated by substituting a first-offer right for the first-refusal right in the Blackacre example in Subpart II.A above: the owner of Whiteacre and Blackacre grants a first-offer right for Blackacre's purchase. That is, if the owner decides to sell Blackacre, perhaps after preliminary discussions with potential purchasers, the holder will be given notice and a specified period during which to make an offer to buy Blackacre. The owner may accept the offer or may, within a specified period, sell Blackacre to a third party at a price higher than that offered by the holder.[362]

[361] *See* discussion *supra* Part II.C (discussing options).

[362] A variation on this arrangement is a first-offer right at an appraised price. Under this scheme, an owner willing to sell must have the property appraised and must provide the holder with an opportunity to purchase it at the appraised price. If the holder declines, the owner may sell the property unencumbered for a specified time period at the appraised or a higher price. A further variation requires the owner to propose a price to the holder, which, if not accepted, becomes the seller's floor for negotiation with third parties.

B. The Commitment to Negotiate

The commitment to negotiate, which often is seen in the employment context, specifies a period of time during which the contracting parties commit to negotiate exclusively with each other in good faith. If time is critical, the existence of an exclusive negotiating period puts pressure on the parties to reach an agreement.

C. The Commitment to Auction

The auction commitment is a sealed bid process. The holder is notified of the owner's intention to sell the property and the date when sealed bids are due.[363] The owner can set a reservation price, that is, the minimum price at which the owner will sell, and the entire process can be managed by an escrow agent to ensure fairness. On the due date, the bids are opened, and the property either will be sold to the highest bidder or retained by the owner, if no bid exceeds the reservation price.

XI. CONCLUSION

A boilerplate and poorly drafted first-refusal right often results in unnecessary and expensive litigation between the grantor, the holder, and a third party. Although contracting parties may not be able to anticipate every potential dispute or triggering event, careful attention to the issues discussed in this article and the alternatives to first-refusal rights may reduce costly legal battles.

[363] The procedure could also be carried out in two steps. In a two-step procedure, the owner would notify the holder of the owner's intention to offer the property for sale and the holder then would be required to trigger the sealed bid auction process. The two-step procedure would bypass the auction process efficiently, if the holder had no interest in, or ability to, acquire the property.