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Right of First Refusal, Right?

Illinois courts do not treat all rights of first refusal equally.



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A RIGHT OF FIRST REFUSAL (ROFR) IS AN AGREEMENT GIVING ITS HOLDER THE right to purchase property in certain circumstances. ROFRs usually concern real estate, but they can cover any type of property.

Generally, ROFRs provide that if an owner receives a *bona fide* offer to buy its property on terms it wishes to accept, the owner must give the ROFR holder notice of the offer and the opportunity to match it. The ROFR holder has no obligation to match the offer and it can refuse to do so. In that instance, the owner is free to sell the property to the offeror. If the ROFR holder does match the offer, the holder has the right to buy the property and the owner must sell it to the ROFR holder.

An ROFR can potentially make property less marketable because prospective buyers may decide not to make an offer out of fear of wasting time conducting due diligence and proceeding to a purchase only for the property to be snapped up by the ROFR holder. On the other hand, prospective buyers may not learn about the ROFR at the time of their initial bid; or, incentivized by it, may attempt to outbid the ROFR holder.

Under Illinois law, ROFRs generally are enforceable but can lead to litigation. One common dispute is whether a property's ROFR provisions are definite enough to be enforced. This article will discuss that issue, including the authors' view that Illinois law is unnecessarily technical and should recognize an ROFR as a term of art that gives the holder the right to buy or use the property if the holder matches the price offered by a third party.

The definition of an ROFR

In *Kellner v. Bartman*, the court described an ROFR and its distinguishing characteristics:

A right of first refusal, also referred to as a preemptive right, is a condition precedent to the sale of the property. A right of first refusal is not an option in that the holder of the right cannot force the sale of the property at a stipulated price. ... Instead, the right does not arise until the grantor notifies the holder of a desire to sell or until offering or contracting to sell to a third party without first giving the holder of the right of first refusal the opportunity to buy. ... Oftentimes, a right of first refusal is a right to elect to take specified property at the same price and on the same terms and conditions as are contained in a good-faith offer to purchase made by a third party.¹

The court noted that, to be enforceable, a right of first refusal "need not specify the price and terms, as long as it provides a method whereby the price and terms may be ascertained."² It also noted that "[m]any terms and conditions of the sale upon the exercise of the right of first refusal may be supplied by implication or custom."³

1. *Kellner v. Bartman*, 250 Ill. App. 3d 1030, 1034 (4th Dist. 1993).
2. *Id.* at 1035.
3. *Id.*

TAKEAWAYS >>

- In Illinois, right-of-first-refusal (ROFR) agreements may end up in litigation when a dispute arises over whether a property's ROFR provisions are definite enough to be enforced.
- Many Illinois courts will not enforce an agreement that simply says that one party has an ROFR with respect to particular property if the agreement lacks specificity.
- ROFR agreements in Illinois should include the specific terms of a *bona fide* offer from a third party that the property owner is willing or intends to accept.

Is the ROFR sufficiently definite?

Like other agreements, ROFRs must be sufficiently definite to be legally enforceable. In *Folsom v. Harr*, the parties entered into a lease that contained the following provision:

Should [the defendant] conclude to sell this property, then [the plaintiff] is to have the first chance to buy the same.⁴

In *Folsom*, the defendant sold the property without first offering it to the plaintiff, and the plaintiff sued to enforce its right to buy the property. The court held that the lease provision was unenforceable because it did not provide a mechanism for determining the price of the property—an essential element of any agreement to transfer real estate.

The logic of the court's decision seems unassailable. Suppose the owner had done nothing more than decide to sell the property and there were no listing price, no public notice of sale, and no third-party buyer. Could the holder have enforced its purported right to buy the property? Clearly not. On what price would the sale be based? What would happen if the seller and the ROFR holder could not agree on a price? The parties' agreement provided no way to determine the critical price element of any potential sale, so the agreement could not be enforced.

Although the *Folsom* court held that the lease provision was unenforceable, it made an observation helpful to future litigants. The court stated that the lease provision would have been enforceable

if it had said that the plaintiff had the right to buy the property on the terms offered by a third party.⁵ Such a reference would give the court a basis for filling in the missing price and other terms and would make the contract definite and enforceable.

This principle was tested almost a century later in *Kellner* where the parties entered into a real estate contract with a provision that read:

In the event [the defendant] shall decide to sell his remaining farm land . . . , he shall first offer the farm land to [the plaintiff] for the price and on the terms of the intended sale, by an instrument in writing, delivered or mailed to [the plaintiff] . . .⁶

The defendant sold the land without offering it to the plaintiff, and the plaintiff sued. The trial court granted summary judgment for the defendant holding that the ROFR provision was too indefinite as to the sale price. The appellate court reversed. It held that the ROFR was enforceable because it contained a method for determining the price by referring to "the price and . . . terms of the intended sale" to the third party.⁷

Folsom and *Kellner* recognize that an ROFR is enforceable so long as it provides a way to determine the price and other material terms of the parties' agreement. Typically, the price and other material terms are the same as those contained in a *bona fide* offer

4. *Folsom v. Harr*, 218 Ill. 369, 370 (1905).

5. *Id.* at 373.

6. *Kellner*, 250 Ill. App. 3d at 1032.

7. *Id.*

IN ILLINOIS, SOME COURTS ... REQUIRE THE ROFR TO SPECIFICALLY REFER TO MATCHING THE TERMS OF ANOTHER PERSON'S OFFER. THOSE COURTS WILL NOT ENFORCE AN AGREEMENT THAT SIMPLY SAYS THAT ONE PARTY HAS AN ROFR WITH RESPECT TO PARTICULAR PROPERTY.

by a third party. Indeed, Black's Law Dictionary defines a right of first refusal as a "potential buyer's contractual right to meet the terms of a third party's higher offer."⁸ In addition, nonessential terms can be implied by custom and practice.⁹

Implicit doesn't guarantee enforceability

Persons who wish to create or enforce an ROFR in Illinois need to be mindful. In some states, the words "right of first refusal" are considered a term of art with an established meaning that enables them to be enforced without elaboration. But in Illinois, some courts reject that approach and require the ROFR to specifically refer to matching the terms of another person's offer. Those courts will not enforce an agreement that simply says that one party has an ROFR with respect to particular property.

An example is *Universal Scrap Metals, Inc. v. J. Sandman & Sons, Inc.*¹⁰ There, the parties entered into a sales agreement for a scrap-metal company that contained the

following provision:

If at some future time [the defendant] decide[s] to sell, relinquish or limit participation in the business, it is agreed that [the plaintiff] will have the "right of first refusal" to purchase, manage, or otherwise operate [the defendant's] business under mutually agreed upon conditions.¹¹

Later, the defendant sold the business's assets without first offering them to the plaintiff, and the plaintiff sued for breach of contract. The trial court dismissed the plaintiff's claim on the ground that its ROFR was too indefinite to be enforced and the appellate court affirmed.

The plaintiff argued that its use of the term "right of first refusal" provided all the definiteness that was needed because an ROFR has an inherent meaning that gives the holder the right to buy the property (here, the assets of a business) on the same terms that the third party had offered. The court quickly dispatched that argument:

If "right of first refusal" inherently meant that the right could be exercised on the terms of a third-party offer ... any further description of the right of first refusal, such as the phrase "under mutually agreed upon conditions" would be superfluous. Indeed, the term "under mutually agreed upon conditions" indicates that the parties contemplated negotiations beyond their initial agreement. Had the parties intended to expressly base their selling price on a third-party offer, they could have provided so in the agreement.¹²

The court also noted that the ROFR at issue was not limited to the right to buy the business but also included the right to manage or operate it if a sale did not take place:

Furthermore, the agreement refers not only to the sale of [the company] but also

discusses Universal's possible management or operation of [it], which might occur without the involvement of a third party.¹³

The ROFR in *Universal* was broader than the way an ROFR is typically used because it covered the sale, management, and/or operation of the business. But its fatal defect was that it said that the parties would negotiate "mutually agreed upon conditions." That phrase turned what might have been a valid ROFR into an unenforceable "agreement to agree."

The *Universal* plaintiff asked the court to acknowledge that an ROFR is a term of art and "to join the jurisdictions that hold that a right of first refusal means that the holder of the right is obligated to pay the price offered by a third party."¹⁴ The appellate court declined this request:

Although a right of first refusal often does involve a third-party offer, *Kellner* acknowledges the right can also arise when a grantor notifies the holder of the right "of a desire to sell." ... Numerous Illinois cases have described rights of first refusal in greater detail and with options that are unrelated to third-party offers.¹⁵

Crestview Builders, Inc. v. Noggle Family Limited Partnership illustrates a similar point.¹⁶ There, the parties agreed that a family trust would sell 220 acres of land to Crestview with some of the land being sold in each of three separate closings. The trust retained a homestead on the land but orally agreed to give Crestview an ROFR on the homestead.

Neither party mentioned the agreement during the first two closings, but at the third closing, the parties inserted the following language into the closing statement:

[The trust] agrees to comply with the requirements [of the prior agreement] by delivering a recordable right of first

ISBA RESOURCES >>

- Karen G. Courtney, *An Overview of Housing Cooperatives in Illinois*, Real Property (Apr. 2018), law.isba.org/2USYUZP.
- Gary R. Gehlbach, *What Is a "Right of First Refusal"?*, Real Property (Dec. 2006), law.isba.org/2J4AKsM.
- James K. Weston Sr., *Right of First Refusal Enforced*, Mineral Law (Aug. 2004), law.isba.org/3m0KC5f.

8. *Right of first refusal*, Black's Law Dictionary (11th ed. 2019).

9. *Kellner*, 250 Ill. App. 3d at 1035 ("Many terms and conditions of the sale upon the exercise of the right of first refusal may be supplied by implication or custom.")

10. *Universal Scrap Metals, Inc. v. J. Sandman & Sons, Inc.*, 337 Ill. App. 3d 501, 503 (1st Dist. 2003).

11. *Id.*

12. *Id.* at 506.

13. *Id.*

14. *Id.* at 505.

15. *Id.* at 507.

16. *Crestview Builders, Inc. v. Noggle Family Limited Partnership*, 352 Ill. App. 3d 1182 (2d Dist. 2004).

refusal to [Crestview] by 12/30/00 for the homestead.¹⁷

Thereafter, the parties negotiated the terms of the ROFR but they could not agree on how long the ROFR would last. Crestview wanted the ROFR to last for 10 years; the trust wanted it to last for three. Ultimately, the trust transferred its homestead without giving Crestview the opportunity to buy it. Crestview sued for a declaration that its ROFR was valid and for specific performance. The trial court ruled that Crestview did have a valid ROFR, and the trust appealed.

On appeal, the trust argued that Crestview's ROFR was unenforceable because it did not specify a method for ascertaining the homestead's price. Citing Black's Law Dictionary and other authorities, Crestview argued that the words "right of first refusal" meant that Crestview had the right to match the third party's offer.

The Second District of the Illinois Appellate Court rejected Crestview's argument and reversed the trial court. The Second District held that:

Although a right of first refusal often involves a third-party offer, that is not always so. Thus, the term "right of first refusal" does not, in itself, provide a method of determining the price.¹⁸

In the authors' view, the *Crestview* decision is correct, but its reasoning is defective and too formal. A right of first refusal almost universally means that its holder has the right to match the terms of another person's *bona fide* offer. The fact that an ROFR theoretically could refer to some other source for price or other terms does not justify ignoring the meaning that an ROFR typically has. Nevertheless, the ultimate decision in *Crestview* is correct, because ROFRs can remain in effect for different periods of time. In *Crestview*, the parties could not agree on whether the ROFR should last for three years or 10. The parties' failure to agree on this material term meant that they never reached a meeting of the minds, and no ROFR was created.

Illinois law needs an update

Crestview and *Universal* provide a clear warning that to pass muster in Illinois, the term "right of first refusal" should say that the holder has a right of first refusal *to match the terms of a bona fide offer from a third party* that the property owner is willing or intends to accept. This is the inherent meaning of an ROFR, and it is recognized as such by many other states that do not require the italicized words to be present before they will enforce an ROFR.¹⁹ In our view, Illinois law should recognize this inherent meaning but errs in refusing to enforce an ROFR unless the italicized words (or some version thereof) are present. The possibility that a person might use the term ROFR improperly or to mean something different from its usual meaning—as shown in some of the Illinois cases described above—should not rob the term ROFR of its standard and recognized meaning.

The central issue in enforcing an ROFR is whether the material terms of the contract can be determined. Once the property itself is described, the primary issue is whether there is a reliable method for determining a price. When the term ROFR is used, the price term is self-evident: It is the price that a third party has offered. There is no mystery and there is no legitimate purpose served by pretending that a mystery exists. The seller of the property made a contract to give another person the first right to buy the property. That contract, like all other lawful agreements, should be enforced without any special requirement.

The idea that a missing term should invalidate an agreement also is inconsistent with Illinois cases holding that custom and practice can supply missing terms in a real estate contract. For example, the First, Third, and Fourth districts of the Illinois Appellate Court have held that custom and practice can supply missing terms regarding the proration of taxes, closing costs, and

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the type of deed to be conveyed.²⁰

At least one Illinois court has recognized this principle in the ROFR context.²¹ But, in our view, Illinois courts should go further by recognizing that an agreed-upon price term—the price offered by the *bona fide* third party—is inherent in the phrase "right of first refusal." 

17. *Id.* at 1184.

18. *Id.* at 1187 (internal citations omitted).

19. *E.g., Keeper's, Inc. v. ATGCKG Realstate, LLC*, 80 A.3d 88, 94 (Conn. App. Ct. 2013) ("right of first refusal" is a term of art with a fixed meaning); see also *Uno Rests., Inc. v. Bos. Kenmore Realty Corp.*, 805 N.E.2d 957, 964 (Mass. 2004); *Polemi v. Wells*, 759 P.2d 796, 799 (Col. App. 1988); *Janas v. Simmons*, No. WD-86-60, 1987 Ohio App. LEXIS 6433, *23-31 (Ohio Ct. App. Apr. 17, 1987); *Palmer v. Liles*, 677 S.W.2d 661, 665 (Tex. App. 1984); *Di-Maria v. Michaels*, 455 N.Y.S.2d 875, 877 (N.Y. App. Div. 1982); *Krupinsk v. Birsk*, 278 A.2d 757, 759 (Vt. 1971); *Bennett Veneer Factors Inc. v. Brewer*, 441 P.2d 128, 134 (Wash. 1968); *Nelson v. Reisner*, 331 P.2d 17, 22-23 (Cal. 1958); *Barling v. Horn*, 296 S.W.2d 94, 97-99 (Mo. 1956); *Tamura v. Iulius*, 281 P.2d 469, 472 (Or. 1955); *Brenner v. Duncan*, 27 N.W.2d 320, 322 (Mich. 1947); *Parker v. Murphy*, 146 S.E. 254, 258 (Va. 1929).

20. See, *e.g., White Hen Pantry, Inc. v. Cha*, 214 Ill. App. 3d 627, 634-35 (1st Dist. 1991); *Kane v. McDermott*, 191 Ill. App. 3d 212, 218-20 (4th Dist. 1989) (taxes, closing, and warranty deed provisions could be supplied by implication); *Yoder v. Rock Island Bank*, 47 Ill. App. 3d 486, 491 (3d Dist. 1977) (minor items, such as transfer of possession and amount of title insurance, may be left to the option of one of the parties or may be determined by what is customary or reasonable).

21. *Kellner v. Bartman*, 250 Ill. App. 3d 1030, 1035 (4th Dist. 1993) ("Many terms and conditions of the sale upon the exercise of the right of first refusal may be supplied by implication or custom.").