

## Rights of First Refusal and First Offer: Assessing a Tenant's Rights

Many commercial tenants, depending upon market conditions and their overall leverage in a transaction, are able to negotiate for a right of first refusal or first offer to purchase the property they lease. A right of first refusal typically provides the tenant a right to match a third-party offer to buy the property, whereas a right of first offer provides the tenant with the first opportunity to buy the property on material economic terms that are proposed by the seller. From the perspective of both landlord and tenant, any such provision should be carefully drafted in the lease so that the rights and obligations of the parties are unambiguous, and there are no misunderstandings or disagreements as to how and when the clause is triggered.

### What Are Tenants' Rights? Do They Still Exist?

Often the specific details of the purchase right are contained in the original lease. A memorandum of lease, which puts third parties on notice as to the existence of such right, is often recorded in the land records. While the terms may originally seem clear to both parties, what transpires over the course of time can often muddy the waters. For instance, the lease could be amended with or without a clause that provides that all terms of the original lease, as amended, remain in full force and effect. Another situation may involve the written lease term expiring and the tenant becoming a "month-to-month" tenant without any writing addressing whether the purchase right was intended to extend into the month-to-month tenancy. In situations such as these where the result is not clear, applicable case law in a given state should be researched to fill in the gaps and help interpret such ambiguous provisions.

This article will address New York and New Jersey case law on the subject.

### New York Cases

In New York, there is some guidance on the matter.



**Mark S. Levenson**

*Mark Levenson is a Co-Chair of the Sills Cummis & Gross Real Estate Department.*



**Jeffrey Meltzer**

*Jeffrey Meltzer is a Member of the Sills Cummis & Gross Real Estate Department.*

*The views and opinions expressed in this article are those of the authors and do not necessarily reflect those of the firm or its clients.*

In *Gulf Oil Corp. v. Buram Realty Co.*, 11 N.Y.2d 223 (1962), the Court of Appeals ruled that a purchase option contained in a lease, which could be exercised “at any time during the term,” did not become part of 22 successive extension agreements executed after the initial lease term expired. The court reasoned that the extension agreements did not preserve the tenant’s purchase option as they were new agreements separate and apart from the renewal options contained in the original lease, and there was nothing definitively stated in the extension agreements that manifested a clear intention to incorporate the purchase option.

In *Galapo v. Feinberg*, 266 A.D.2d 150 (1st Dept. 1999), the court examined whether a tenant’s purchase option, which was contained in the original lease and conditioned on tenant not being in default under the lease, carried over into a month-to-month tenancy. In deciding that the purchase option was no longer effective, the court stated that “an option to purchase contained in a lease is, unless expressly reaffirmed in a subsequent lease or extension thereof, only valid during the term of the original lease ... which, in this case, had expired.” The court so concluded *even though* the landlord’s attorney mistakenly sent a letter to the tenant, after the right of first refusal had expired, reminding tenant of the right of first refusal contained in the original lease. The fact that the tenant had been paying less rent than prescribed in the lease also had the effect of terminating the option, because the tenant had not honored the terms of the lease, although the landlord never declared the tenant in default and did not reject the reduced rent that the tenant was unilaterally paying.

In *Coinmach Corp. v. Fordham Hill Owners Corp.*, 3 A.D.3d 312 (1st Dept. 2004), the tenant sought to enforce a right of first refusal relating to the installation and operation of laundry machines while it was a month-to-month tenant. The original lease provided that “at the expiration of this Lease or any renewal, Lessee shall have the right of first refusal to meet any bona fide bid to lease the laundry room(s) and/or provide coin-metered laundry equipment services to the Premises.” However, the original lease term expired, and the

tenant became a month-to-month tenant. When the tenant sought to enforce its rights, the court held that the right of first refusal was not valid during the term of the month-to-month tenancy because there was no written agreement extending that right into the month-to-month tenancy. The court ruled that “the right of first refusal is an exception to the general rule that the covenants of the lease are extended into a month-to-month tenancy” and such right “must be expressly reaffirmed” in order for it to survive expiration of the written lease term.

The court also reached a similar result in *Pepe v. Stock*, 24 A.D.3d 527 (2nd Dept. 2005), finding that the tenant’s right of first refusal was no longer enforceable because the lease term had expired without being extended.

## New Jersey Cases

New Jersey case law is similar to that of New York in holding that rights of first refusal and first offer contained in a lease do not carry over beyond the written lease term, even though the tenant may still be in possession of the premises.

In *Andreula v. Slovak Gymnastic Union Etc.*, 140 N.J. Eq. 171 (Ch. 1947), the lease provided the tenant with “the first option to purchase” the premises. After the written lease term expired, the tenant remained in possession as a month-to-month tenant and continued to pay rent. Subsequently, the tenant learned that the landlord was under contract to sell the premises to a third party, and then sued the landlord to enforce his purchase rights under the lease. The court found the tenant was a holdover month-to-month tenant, and “an option to purchase contained in a written lease cannot be exercised after the expiration of the written lease by a tenant holding over since it is a collateral contract, independent of the lease.” In other words, the option to purchase had expired with the expiration of the written lease term, and the fact that the tenant remained in the premises as a month-to-month tenant was irrelevant because the option was “not to be regarded as a provision incident to the relation of landlord and tenant.”

A similar result was reached by the Appellate Division of the Superior Court of New Jersey in *Patel v. 323 Cent. Ave. Corp.*, 2008 N.J. Super. Unpub. Lexis 2444, where a physician sued to enforce the right to purchase an office building where he was leasing space. The court found that the tenant's purchase rights expired at the end of the written lease term, and the tenant, as a holdover tenant, could not exercise the purchase right after the written lease term had expired. Thus, the landlord's subsequent sale of the property to a third party, without giving tenant the first opportunity to purchase, did not violate the terms of the lease.

The Appellate Division ruled similarly in *Fedderly v. Skoda*, 2009 N.J. Super. Unpub. Lexis 1827, where an office lease included a right of first refusal to lease additional space in the building. The lease term was extended via a series of one-year extensions, after which the tenant became a month-to-month tenant and then sought to enforce the right of first refusal contained in the original lease. The Appellate Division, relying on *Andreula*, ruled that the tenant was a holdover tenant, and the right of first refusal previously expired at the expiration of the written lease term. The court reasoned that a right of first refusal does not survive the written lease term because it is a "collateral agreement, independent of the lease," and the tenant could therefore only exercise it during the written lease term.

These cases are contrasted with *Balsham v. Koffler*, 8 N.J. Super. 48 (App. Div. 1950), which involved a lease with a one-year term that expressly provided for renewal on a month-to-month basis thereafter. The court in *Balsham* ruled that the tenant's purchase option was still valid during the month-to-month portion of the lease because the additional month-to-month term was provided for in the original lease and was therefore not a new demise, but a continuation of the old one. In other words, at the time the option was exercised, the tenant was *not* a holdover tenant, but a tenant holding under the lease.

## Conclusion

Based upon these cases, where a written lease term is expiring and the tenant is transitioning to a month-to-month tenancy, the tenant must enter into some writing with its landlord to confirm that its purchase right under the original lease remains effective. In New York, absent such written confirmation, the tenant's purchase rights (in whatever form) will most likely be found to have expired. A similar outcome is likely in New Jersey, unless the month-to-month lease term was expressly provided for in the original lease.

Naturally, to limit potential conflicts and avoid litigation, which may obstruct or delay a sale in the future, lease clauses of this type must be carefully drafted at the outset, so as to fill in the pertinent details and leave less to the interpretation of a party seeking to enforce a purchase right it believes is still effective or has been triggered by certain acts of the owner.