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THE LEGAL CONSTRUCTION OF RIGHTS OF FIRST REFUSAL

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The Anglo-Canadian jurisprudence of rights of first refusal is thin and unsettled. The American case law is more extensive, but equally problematic. Presently, a basic right of first refusal may be defeated or circumvented in a variety of ways. The author explores some of the considerations the parties, especially the prospective holder, ought to address when negotiating and drafting a first refusal.

La jurisprudence de common law canadienne sur le droit de préemption est mince; elle n'est pas fixée. La jurisprudence américaine est plus considérable; elle n'en demeure pas moins aussi problématique. Présentement, on peut mettre en échec un droit de préemption ordinaire ou le contourner de diverses façons. L'auteur explore certaines des considérations que les parties, spécialement celle qui projette devenir détentrice du droit de préemption, devraient avoir à l'esprit lors de la négociation et de la rédaction d'une convention de préemption.

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Introduction

Rights of first refusal tend to be drafted in seemingly straightforward terms. The typical provision requires the vendor to give the holder of the right the first opportunity to purchase the subject property on terms the vendor is willing to accept, usually terms specified in a *bona fide* offer from a third party.[1] The ostensible simplicity of the typical provision, however, masks an expansive and often problematic default jurisprudence. In fact, a great deal of elaboration is required before it is possible to identify, even in a tentative way, the respective legal positions of the parties involved. That elaboration is undertaken below.

The discussion proceeds with two connected objectives in mind. The first is to identify the default regime of legal regulation applicable to rights of first refusal.[2] This involves asking what legal consequences arise in the absence of the parties' fully-contingent specification of their contractual obligations. The correlative objective is to inform the practical negotiation of rights of first refusal. Knowledge of the default regime is obviously a critical factor in the

[1] See the various forms in O'Brien's *Encyclopedia of Forms*, 11th ed. (Toronto: Canada Law Book, 1996) (looseleaf service). A basic provision for a commercial lease (eg. Form 18.2) would be:

> The Tenant is granted the right of first refusal to purchase the Premises during the term of this lease or any renewal or extension thereof [and six months thereafter], on the terms of any *bona fide* written offer received by the Landlord which the Landlord is willing to accept, the written offer to be submitted by registered letter mailed to the Tenant, and the Tenant to have two months from its receipt within which to notify the Landlord that it elects to purchase the Premises. If the Tenant elects not to purchase the Premises the Landlord may sell them pursuant to the terms of the offer, and this right of first refusal then ceases. If, however, a sale is not completed on the offer then this right of first refusal continues in full force and effect.

[2] As to the nature of "default" regulation in general, see the several symposium articles published at (1993) 3 S. Cal. Interdisc. L. J. 1-444.

negotiation of any right of first refusal. Those default rules which are objectionable to one of the parties for whatever reason must, where possible, be displaced or modified through negotiation. Those default rules which are acceptable or useful may be left unaltered, allowing for their subsequent application or instrumental employment as required. The protections or advantages either party might thereby acquire in this negotiation will plainly depend, in large part, on their relative comprehension of the extant default arrangements.

Although the bare right may be acquired separately, rights of first refusal are more often associated with other transactions.[3] The right tends to be found in, for example, leases, partnership agreements and shareholder agreements.[4] The context in which the right operates, it should be appreciated, does matter. In particular, where the subject property is an interest in land, distinct considerations will apply. The following discussion focuses primarily on the application of rights of first refusal in the real property context.[5] Within that context the discussion is intended to be general, although it is worth noting that many of the cases involve leases and that a good portion of the American literature is concerned with natural resource (primarily oil and gas) transactions.[6]

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[3] While associated with other transactions, they are said to exist as independent agreements. See *Budget Car Rentals Toronto Ltd.* v. *Petro-Canada Inc.* (1989), 60 D.L.R. (4th) 751 (Ont. C.A.); *Royal Trust Corporation of Canada* v. *Mahoney* (1993), 34 R.P.R. (2d) 65 (Ont. Gen. Div.). Note that a holder who breaches the terms of the associated transaction (eg. refusal to make lease payments) may be precluded from enforcing the right of first refusal. See the annotation at 53 ALR (3d) 435 reviewing some of the American cases on this issue.

[4] Eg. *GATX Corp.* v. *Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont. Gen. Div.); *Trimac Limited* v. *C-I-L Inc.*, [1990] 1 W.W.R. 133 (Alta. Q.B.); *In Re Club Associates*, 951 F. 2d 1223 (11th Cir. 1992); *American Broadcasting Companies, Inc.* v. *Wolf*, 430 N.Y.S. 2d 275 (App. Div. 1980).

[5] See K.T. Smith & S.H.T. Denstedt, "Preemptive Rights and the Sale of Resource Properties: Practical Problems and Solutions" (1992) 30 Alta. L. Rev. 57; P.M. Perell, "Options, Rights of Repurchase and Rights of First Refusal as Contracts and as Interests in Land" (1991) 70 Can. Bar Rev. 1.

[6] H. Abright, "Preferential Right Provisions and Their Applicability to Oil & Gas Instruments" (1978) 22 S.W.L.J. 804; G.B. Conine, "Property Provisions of the Operating Agreement — Interpretation, Validity, and Enforceability" (1988) 19 Tex. Tech L. Rev. 1263; J. R. Cooney & L.P. Ausherman, "Preferential Purchase Rights in Mineral Agreements" (1991) 37 Rocky Mt. Min. L. Inst. 9-1; J.K. Borgerson & B.T. Dolan, *Preferential Purchase Rights*, Institute on Mining Agreements II, Rocky Mountain Min. L. Fdn., 1981, 11-1; W.A. Keefe, "The Oil and Gas Joint Operating Agreement: Unravelling Some Knots" (1990) 36 Rocky Mt. Min. L. Inst. 18-1; G.F. Kutzschbach, "Operating Agreement Considerations in Acquisitions of Producing Properties" (1985) 36 Inst. on Oil and Gas Law and Taxation 7-1; A. Minter & A. G. Wacker, "The Rights and Obligations of Parties to Joint Operating Agreements Under Preferential Right to Purchase Provisions" (March/April, 1990) Landman 22; H.M. Reasoner, "Preferential Purchase Rights in Oil and Gas Instruments" (1967) 46 Tex. L. Rev. 57; J.J. Scott, "Restrictions on Alienation Applied to Oil and Gas Transactions" (1985) 31 Rocky Mt. Min. L. Inst. 15-1; J.S. Sellingsloh, "Preferential Purchase Rights" (1966) 11 Rocky Mt. Min. L. Inst. 35.

The Anglo-Canadian position is examined and extensive reference is made to the American authorities.

I. *The Nature of the Right*

While a right of first refusal is a valuable contractual right,[7] it is not an interest in land[8] unless deemed so by legislation.[9] However, when the right is triggered, it immediately converts into an option, which is a caveatable equitable interest in land.[10] The right is triggered in the usual case[11] by the receipt of an offer the vendor is prepared to accept.[12] The option so created will be exercisable within the time period specified in the right of first refusal and, if exercised, will result in a binding contract of sale. If not exercised, the option will terminate when the triggering offer is accepted and results in a contract between the vendor and the third party purchaser. Usually, by its terms, the right of first refusal will continue to affect the property if the triggering offer does not result in a contract.[13]

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[7] Such that compensation is payable upon an expropriation. See *Progressive Developments (1978) Ltd.* v. *City of Winnipeg* (1982), 145 D.L.R. (3d) 405 (Man. C.A.).

[8] *Canadian Long Island Petroleums Ltd.* v. *Irving Industries* (1974), 50 D.L.R. (3d) 265 (S.C.C.).

[9] Eg. *Law of Property Act*, R.S.A. 1980, c. L-8, s. 59.1(1)(a) (amendment, *Real Property Statutes Amendment Act*, 1985, S.A. 1985, c. 48); *Property Law Act*, R.S.B.C. 1979, c. 340, s. 9.

[10] *McFarland* v. *Hauser* (1978), 88 D.L.R. (3d) 449 (S.C.C.); *Powers* v. *Walter* (1981), 124 D.L.R. (3d) 417 (Sask. C.A.); *Canada Trustco Mortgage Co.* v. *Skoretz* (1983), 147 D.L.R. (3d) 130 at 136 (Alta. Q.B.).

[11] As to an offer from the vendor personally, see *infra* footnote 16.

[12] *Canadian Long Island Petroleums Ltd.* v. *Irving Industries*, *supra* footnote 8 at 277; *Kopec* v. *Pyret*, [1987] 3 W.W.R. 449 (Sask. C.A.), at 458. The offer must be "capable of acceptance." See *Downtown King West Development Corporation* v. *Massey Ferguson Industries Limited* (1996), 133 D.L.R. (4th) 550 (Ont. C.A.).

Query whether a true option is created such that the holder may purchase the property within the specified time even though the third party offer has been withdrawn. See again *Downtown King West Development Corporation* v. *Massey Ferguson Industries Limited* (this note). Compare *Henderson* v. *Nitschke*, 470 S.W. 2d 410 (Tex. App. 1971) and *Lin Broadcasting Corporation* v. *Metromedia, Inc.*, 542 N.E. 2d 629 (N.Y. 1989). The court in the latter case takes a narrow view of the function of a right of first refusal (ie. to restrict third-party sales), denying the function of the right in enabling the holder to acquire the property when the vendor eventually decides to sell (at 633-34).

[13] *Supra* footnote 1. Also see Abright, *supra* footnote 6 at 818-19 and *Barling* v. *Horn*, 296 S.W. 2d 94 (Mo. 1956). A subsequent transaction with a third party apparently need not be on exactly the same terms. It may be sufficient that the terms are not more favourable than those offered the holder. See *Rusonik* v. *Texaco Canada Inc.* (1988), 63 O.R. (2d) 534 (H.C.).

Before conversion into an option, the essential feature of a right of first refusal is the grant of a preference contingent upon the willingness of the vendor to sell.[14] After conversion, the discretion to act shifts to the holder of the right of first refusal who, pursuant to the option, may choose whether or not to compel a sale. The terms of sale to the holder will be ascertained upon the creation of the option and will correspond to the terms offered by the third party purchaser.[15] Whether or not a right of first refusal is triggered by a third party offer, the vendor and holder of the right remain free throughout their relationship to negotiate a sale on agreed terms.[16] If a right of first refusal is triggered and the holder exercises the option but subsequently repudiates the contract, the right may be extinguished, even though the proposed sale triggering the right is never subsequently completed.[17]

Rights of first refusal serve different purposes for their holders.[18] The effect of the right, obviously, is to allow the holder to eventually acquire the property from a vendor who may or may not be presently willing to sell. Often the motive of the holder is simply to acquire the property as soon as possible. However, even if the vendor is willing to sell, a right of first refusal might still be taken because the current asking price is exorbitant or perhaps because an immediate purchase is financially infeasible or the holder wishes to evaluate the viability of a particular use of the property (eg. through a lease) before committing to a purchase. A straight option may be unavailable or might be unnecessary in the circumstances if, for

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[14] *Kopec* v. *Pyret*, *supra* footnote 12 at 455.

[15] The original parties might instead set a fixed price at which the holder may purchase the property once the right is triggered (eg. *Wyssling (Trustee of)* v. *Latreille Estate* (1990), 9 R.P.R. (2d) 223 (Ont. H.C.)). Where that is done, the provision will properly still be characterized as a right of first refusal, since the holder remains unable to compel the sale. Thus, it would be wrong to conclude that fixing the price creates a straight option rather than a right of first refusal (eg. compare *Schmidt* v. *Downs*, 775 P. 2d 427 at 431 (Utah App. 1989) and *Brauer* v. *Hobbs*, 391 N.W. 2d 482 (Mich. App. 1986)). At the same time, however, fixing the price may possibly render the provision invalid as an undue restraint on alienation (see *infra* text accompanying footnote 33).

[16] Entertaining an offer made by the vendor personally will likely not extinguish the right of first refusal. See *Kopec* v. *Pyret*, *supra* footnote 12 at 456; *Vancouver Key Business Machines Ltd.* v. *Teja* (1975), 57 D.L.R. (3d) 464 (B.C.S.C.); *Cortese* v. *Connors*, 152 N.Y.S. 2d 265 (1956). One decision implies that a right of first refusal might be triggered by an offer by the vendor if the amount "can be objectively shown to be a sum a third party would offer". See *Landymore* v. *Hardy*, *infra* footnote 36 at 192-93.

[17] *Canada Deposit Insurance Corp.* v. *Canadian Commercial Bank* (1992), 89 D.L.R. (4th) 168 (Alta. Q.B.).

[18] Borgerson & Dolan, *supra* footnote 6 at 1-3; Cooney & Ausherman, *supra* footnote 6 at 4-5; Minter & Wacker, *supra* footnote 6 at 23, 25; Sellingsloh, *supra* footnote 6 at 35-38, Scott, *supra* footnote 6 at 3-7.

whatever reason, the holder is content to await the offer of a third party. Even where the holder must ensure acquisition by a certain date, it may still be advantageous to take from the vendor both an option *and* a right of first refusal so as to secure thereby the opportunity to acquire the property at a price less than the option price if, for example, the vendor becomes anxious to sell.[19] The motive of the holder may instead be to avoid undesirable relationships or associations with ostensible third party purchasers. This will often be the primary concern of, for example, a lessee or joint owner. Acquisition *per se* is not the operative motive in such cases and the holder who purchases might well promptly re-convey the acquired property to another more compatible purchaser. In these latter circumstances, the device is employed as a form of security or protection against unwanted economic or personal associations.

Vendors who contemplate granting a right of first refusal must consider a variety of factors.[20] It may be that the right forms part of the requested consideration in a transaction which will not otherwise proceed. The vendor may therefore have little choice. In other transactions, however, a vendor may be quite willing to grant a right of first refusal as it might provide a holder in possession of the property (eg. lessee) with an incentive to maintain the property. If the incentive works, the condition of the property may elicit a better offer from a third party and so elevate the eventual sale price beyond what it might have been. A vendor may also be willing to grant the right in the belief that it is a cost-free concession given the absence of an obligation to sell at anything less than an acceptable third party offer. However, there are competing considerations. For example, the incentive to maintain described above may be overcome by the perverse (rational) incentive to the holder to forego adequate maintenance of the property so as to reduce costs prior to purchase and to reduce the purchase price third parties will be prepared to offer. More generally, a vendor must consider whether third party purchasers might be reluctant to incur the costs of evaluating a property that is subject to a right of first refusal.[21] The significance of this concern varies directly with the difficulty (cost) of evaluating the property. These and other considerations suggest the circumstances in which rights of first refusal may be effectively employed.

It is imprudent to proceed very far beyond the foregoing remarks when generally describing the nature of a right of first refusal. This is because the

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[19] It is not uncommon to find a right of first refusal combined with an option. See, for example, *Crowley* v. *Texaco, Inc.*, 306 N.W. 2d 871 (S.D. 1981); *Hawthorne's, Inc.* v. *Warrenton Realty, Inc.*, 606 N.E. 2d 908 (Mass. 1993) and the annotation at 22 ALR (4th) 1293. It may be necessary to structure the option so that it does not violate the right of first refusal (see *infra* text accompanying footnotes 205-219). This could be done, for example, by allowing the option to be exercised only on specified dates in the future if the subject property remains in the possession of the vendor. The right of first refusal will cover proposed sales between those dates.

[20] See references cited at footnote 18, *supra*.

[21] Scott, *supra* footnote 6 at 6.

terms of any right of first refusal are determined in the first instance by the parties themselves. Subject to satisfying the basic elements that define a valid right, the parties are free to construct whatever arrangement meets their peculiar needs. At the same time, however, it will be appreciated that the parties engage in this exercise within a default framework that represents a pre-established judicial construction of the nature of a right of first refusal. Until altered by the private construction, this provisional framework defines the nature of a right of first refusal.

II. *Issues of Validity*

The main issues of validity concern the formation of the contractual obligation. The question is whether the mandatory criteria for a binding obligation found in the general law of contract and property have been satisfied. There are therefore few significant default positions to investigate at this point and only a brief review of matters of validity is warranted.[22]

It may first be observed that a right of first refusal will be invalid if the contract in which it is contained was not properly formed or is unenforceable. That contract (eg., a lease or farmout agreement) may have failed for any of the standard defects in formation or because performance is excused. Similarly, when the right of first refusal is the subject of a separate contract, it must meet the standard criteria for enforcement. These include that the right was acquired in exchange for consideration, that it is not uncertain and that there are no excuses available to the vendor. Thus, for example, it may be insufficient merely to identify the obligation as a "first option" or "right of first refusal" without further specifying the mechanisms necessary to practically effectuate that obligation.[23]

One basic contractual question is whether the typical first refusal constitutes a mere agreement to agree, given that the terms of the sale initially are not fixed.[24] The courts have concluded that the terms are validly established through the mechanism of a third party offer in the usual case and that, accordingly, there is a present agreement. Some courts have even found a present agreement in circumstances where the express wording of the provision might suggest a future consensus. In *Smith* v. *Morgan*, for example, the

[22] Generally, see Perell, *supra* footnote 5; *Cooney & Ausherman*, *supra* footnote 6; Kutzschbach, *supra* footnote 6; Reasoner, *supra* footnote 6, Sellingsloh, *supra* footnote 6; Scott *supra* footnote 6.

[23] *Baykey* v. *North West Office Furniture Ltd.* (1992), 22 R.P.R. (2d) 67 (B.C.S.C.); *Royal Trust Corporation of Canada* v. *Mahoney*, *supra* footnote 3. A right of first refusal may also be unenforceable by reason of the statute of frauds. See *Madison Industries, Inc.* v. *Eastman Kodak Company*, 581 A 2d 85 (N.J. Super. A.D. 1990).

[24] For the American position, see *King* v. *Dalton Motors, Inc.*, 109 N.W. 2d 51 (Minn. 1961); *Anderson* v. *Armour and Company*, 473 P. 2d 84 (Kan. 1970).

provision specified that the holder's right was to have the first opportunity to purchase "at a figure to be agreed upon".[25] The court took the view that the phrase must have related "to the ultimate contract of purchase, if there be one, and not to the offer itself" and, accordingly, there was no mere agreement to agree.[26] Similarly, in *Kopec* v. *Pyret*, the Saskatchewan Court of Appeal found an enforceable obligation even though the holder's right was to purchase on "terms and conditions to be agreed upon between the parties."[27]

Rights of first refusal may also be invalid because they offend the rule against remoteness of vesting or because they are undue restraints on alienation.[28] In the former case, unless the right can be considered an interest in land,[29] the rule only applies to the option created when the right is triggered.[30] In the typical provision, the period in which the option may be exercised is usually very short (e.g. two days, one month) and, consequently, the interest can not possibly vest outside the perpetuity period. Apart from that, legislation in both Canada[31] and the United States[32] has modified the operation of the remoteness rule, thereby further reducing the prospect of invalidation on this basis.

It was observed that rights of first refusal may be challenged on the ground that they restrain alienation of the property and are therefore void. Here Canadian and American courts adopt roughly the same position. No undue restraint exists if the holder's right is to match third party offers. However, a restraint may be found where the right is exercisable at a fixed (lower) price or

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[25] [1971] 2 All E.R. 1500 (Ch. D.). See also *Baykey* v. *North West Office Furniture Ltd.*, *supra* footnote 23 at 72-73 (query (1) the distinction made in this case between *offering* and *accepting an offer* and (2) whether there was really any uncertainty as to price). Also see *Boult Enterprises Ltd.* v. *Bissett*, [1986] 1 W.W.R. 385 (B.C.C.A.).

[26] *Ibid.* at 1503.

[27] *Supra* footnote 12 at 455-56. Also consider *Allen* v. *Allen*, [1994] 6 W.W.R. 323 at 325 (Sask. Q.B.) ("at its then market price at the date of my death, and on terms to be agreed on among my said children").

[28] Borgerson & Dolan, *supra* footnote 6 at 19-28; Cooney &Ausherman, *supra* footnote 6 at 10-16; Kutzschbach, *supra* footnote 6 at 7-14; Reasoner, *supra* footnote 6 at 60-71; Scott, *supra* footnote 6 at 10-15 and the annotation at 40 ALR (3d) 920. See, for example, *Wildenstein & Co., Inc.* v. *Wallis*, 595 N.E. 2d 828 (N.Y. 1992) and *Ferrero Construction Company* v. *Dennis Rourke Corporation*, 536 A 2d 1137 (Md. 1988).

[29] See Smith & Denstedt, *supra* footnote 5 at 68-69. Also see *Re Sutherland* (1991), 82 D.L.R. (4th) 432 (Ont. Gen. Div.) (argument that right was a "limitation" caught by the *Perpetuities Act of Ontario*).

[30] *Re Meewasin Valley Authority and Olfland Land Co. Ltd.* (1987), 42 D.L.R. (4th) 730 (Sask. Q.B.), aff'd. (1988), 51 D.L.R. (4th) 638 (Sask. C.A.). As no interest in land exists prior to the creation of the option, the remoteness rule has no application at that point. For the American position, see the references cited at footnote 28, *supra*. Note that where the right is found to be personal to the holder, the remoteness rule will not apply. See *Mazzeo* v. *Kartman*, 560 A. 2d 733 (N.J. Super. A.D. 1989); *Gore* v. *Beren*, 867 P. 2d 330 (Kan. 1994); *Kellner* v. *Bartman*, 620 N.E. 2d 607 (Ill. App. 1993).

[31] Eg. *Perpetuities Act*, R.S.A. 1980, c. P-4; *Perpetuity Act*, R.S.B.C. 1979, c. 321.

[32] See Scott, *supra* footnote 6 at 14.

a percentage of the price so as to effectively suppress the vendor's power of alienation. As a practical matter, few rights of first refusal are structured this way and, accordingly, few rights are potentially invalid for this reason.[33]

III. *The Default Arrangement*

Although valid, the typical right of first refusal may have no application in the circumstances. The right may or not have been triggered or the transaction may have been expressly or implicity excluded. Whether this is so will, in every case, be a matter of interpretation. Still, a review of the cases can reveal the judicial sense of the basic provision and this will represent the subsisting default interpretation of the circumstances in which the right has application.

It is useful to begin with the broad statements of principle offered by judges to justify their specific conclusions. In *Manchester Ship Canal Company* v. *Manchester Racecourse Company*, the English Court of Appeal stated that a right of first refusal "involves a negative contract not to part with the land to any other company or person without giving that first refusal."[34] The English position has been summarized as a duty not to act "so as to frustrate the right."[35] The existence of this negative covenant in Canada was confirmed in *Canadian Long Island Petroleums Ltd.* v. *Irving Industries*, where Martland J. stated that the right constituted "a negative covenant not to part with [the subject property] to any other person without giving a first right of refusal to the [holder]".[36] Unfortunately, the value of such statements is limited. As formulated by these courts, the proposition is merely a restatement of the right itself. Adding the qualification that the vendor must not act to "frustrate" the right is equally unhelpful. Whether or not the right will be frustrated in the sense that it is wrongfully circumvented will depend on whether the vendor has breached either the express or implied terms of the right or the implied default terms associated with that right. If no breach has occurred, the right simply did not apply and is in no legal sense "frustrated." Statements such as these are perhaps

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[33] *Stephens* v. *Gulf Oil Canada Ltd.* (1975), 65 D.L.R. (3d) 193 (Ont. C.A.); *British Columbia Forest Products Ltd.* v. *Gay* (1978), 89 D.L.R. (3d) 80 (B.C.C.A.). Also see *Allen* v. *Allen*, *supra* footnote 27 and consider *Trinity College School* v. *Lyons* (1995), 47 R.P.R. (2d) 95 (Ont. Gen. Div.) For the American position, see *Wilson* v. *Whinery*, 678 P. 2d 354 (Wash. App. 1984); *DeWolf* v. *Usher Cove Corp.*, 721 F. Supp. 1518 (D.R.I. 1989); *Colby* v. *Colby*, 596 A. 2d 901 (Vt. 1991).

[34] [1901] 2 Ch. 37 at 51 (C.A.).

[35] R. Megarry & H.W.R. Wade, *The Law of Real Property*, 5th ed. (London: Stevens & Sons, 1984) at 607.

[36] *Supra* footnote 8 at 280. And see *Landymore* v. *Hardy* (1991), 21 R.P.R. (2d) 174 at 193 (N.S S.C.) where Saunders J. stated that the "grantor of a right of first refusal is not entitled to frustrate it by conveying the property in such a way as to avoid having to give the right in the first place."

best understood as general admonitions by judges that they will not sanction procedures or arrangements calculated, in their view, to improperly deny or colourably circumvent the operation of a right of first refusal. They are, however, no substitute for the specific definition of objectionable circumstances that must ultimately occur in order to establish the ascertainable content of the obligations of the respective parties.

More recently, a number of Canadian courts have invoked another general principle to regulate the vendor's conduct.[37] The appeal is to a duty of good faith of uncertain scope.[38] Once again, however, this fails to advance the inquiry very far. While finding some support in the American jurisprudence,[39] the operation of a good faith standard remains both relatively unexplored and controversial in Anglo-Canadian law.[40] At this point in its development in this particular context, in any event, its presentation is primarily rhetorical and conclusory, rather than analytical. Obviously it is used by judges to reject those elements of opportunism and sharp dealing they detect and are unwilling to overlook or excuse. However, the notion is analytically empty until its content is defined by concrete illustrations of objectionable conduct or by principles which identify actionable failures to act in good faith. Without that necessary definition, the "good faith" proposition is little more than a platitude. We turn now to the task of establishing at the level of the particular the content of the default regime associated with rights of first refusal.

(a) *Strict Compliance*

Initially it is important to observe that there is a difference between, on the one hand, construing the meaning of a right of first refusal and, on the other, complying strictly with the terms of the option that subsequently arises. The first task of interpretation is to ascertain the intentions of the parties according to general principles of contract construction.[41] In the present context, this mainly

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[37] *Landymore* v. *Hardy*, *supra* footnote 36; *Downtown King West Development Corp.* v. *Massey-Ferguson Industries Limited* (1993), 33 R.P.R. (2d) 27 (Ont. Gen. Div.), rev'd *supra* footnote 12; *GATX Corp.* v. *Hawker Siddeley Canada Inc.*, *supra* footnote 4.

[38] The good faith approach essentially replicates, in its lack of content, the negative covenant approach.

[39] Eg. *Hawthorne's, Inc.* v. *Warrenton Realty, Inc.*, *supra* footnote 19 at 914, and see the dissent in *Schultze* v. *Chevron Oil Co.*, 579 F. 2d 776 (3d Cir. 1978).

[40] See J. Cassels, "Good Faith in Contract Bargaining: General Principles and Recent Developments" (1993) 15 Ad. Q. 56.

[41] *Re Meewasin Valley Authority and Olfland Land Co. Ltd.*, *supra* footnote 30 (Sask. C.A.); *Saugeen Cottagers Organization Inc.* v. *Canada* (1993), 68 F.T.R. 67; *Zouvgias* v. *Chang* (1986), 39 R.P.R. 221 (Ont. H.C.). Also see Sellingsloh, *supra* footnote 6 at 41-42.

involves clarifying the circumstances that trigger the right of first refusal and the conditions to be satisfied to exercise the option.[42] There is no issue of strict compliance at this point.

Once a right of first refusal has been triggered, it seems clear that the holder is required strictly to comply with the conditions for the exercise of the option.[43] Thus, for example, terms relating to notice, tender and payment must be strictly observed. At the same time, however, the courts reserve a jurisdiction to relieve the holder of a right of first refusal of this strict burden.[44] The test for relief, according to the court in *Farr* v. *Attwood*, is "whether as a result of some conduct of the vendor the holder of the option is on equitable grounds relieved from such strict

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[42] Some cases reflect, or insist upon, a strict construction of the right of first refusal. See *Stellar Properties Ltd.* v. *Botham Holdings Ltd.* (1990), 11 R.P.R. (2d) 300 (B.C.C.A.); *Miller* v. *LeSea Broadcasting, Inc.*, 896 F. Supp. 889 at 893 (E.D. Wis. 1995). As to one suggested rationale for a strict construction (social burden of additional costs), see *Frandsen* v. *Jensen-Sundquist Agency, Inc.*, 802 F. 2d 941 at 946 (7th Cir. 1986). Then contrast *Landa* v. *Century 21 Simmons & Co., Inc.*, 377 S.E. 2d 416 at 419 (Va. 1989) ("a right of first refusal is inserted in a contract for the benefit of the person who is given the right and that it must, therefore, be interpreted with that purpose in mind."); *Crowley* v. *Texaco, Inc.*, *supra* footnote 19 at 874 ("A purchase option is placed in a lease for the benefit of the lessee and is to be construed with that in mind") and *infra* text accompanying footnote 230.

[43] *Pierce* v. *Empey*, [1939] 4 D.L.R. 672 (S.C.C.); *Farr* v. *Attwood* (1987), 62 O.R. (2d) 306 (Dist. Ct.), aff'd. (1988), 63 O.R. (2d) 543 (C.A.); *Paslawski* v. *Czerwonka* (1989), 8 R.P.R. (2d) 73 (Sask. C.A.). A right of first refusal is not validly exercised if conditions are asserted by the holder. See *Peterson* v. *Canadian Imperial Bank of Commerce* (1992), 105 Sask. R. 113 (Sask. C.A.). As to conditional third party offers, see *Northwest Television Club, Inc.* v. *Gross Seattle, Inc.*, 612 P. 2d 422 (Wash. App. 1980).

Either the vendor or the holder may be found at fault if the details of compliance are not fully understood. There is American authority for the proposition that "the owner has an initial duty to make a `reasonable' disclosure of the offer's terms, and the rightholder has a subsequent duty to undertake a `reasonable' investigation of any terms unclear to him" (*Koch Industries, Inc.* v. *Sun Company, Inc.*, 918 F. 2d 1203 at 1212 (5th Cir. 1990); *John D. Stump & Associates, Inc.* v. *Cunningham Memorial Park, Inc.*, 419 S.E. 2d 699 (W. Va. 1992).

Different views exist in the United States as to whether the holder can reduce the price by the amount representing commission payable to a real estate agent bringing in the third party offer (*C. Robert Nattress & Associates* v. *CIDCO* 229 Cal. Rptr. 33 (Ct. App. 1986); *David Meyers, Inc.* v. *Anderson*, 739 P. 2d 102 (Wash. App. 1987); *Reef* v. *Bernstein*, 504 N.E. 2d 374 (Mass. App. 1987); *Kenyon* v. *Andersen*, 656 A. 2d 963 (R.I. 1995)). In Canada it appears that the holder can pay the price offered by the third party less the commission (*Landymore* v. *Hardy*, *supra* footnote 36). This seems proper if the amount to be paid by the holder under the provision is that which the vendor is willing to accept. Plainly the vendor is willing to accept the net figure. Receipt of an amount representing commission payable in the third party transaction would be a pure windfall to the vendor.

[44] *Pierce* v. *Empey*, *supra* footnote 43; *Salvati* v. *Bramalea Ltd.*, [1989] O.J. No. 1802 (Dist. Ct.) (QL).

compliance".[45] Relief of this sort, of course, is largely unpredictable and the prudent holder/purchaser should fully satisfy every minor condition that might possibly have been inserted by the vendor with a view to thwarting an effective exercise of the option.

(b) *Unique/Unmatchable Consideration*

A particular issue of compliance is worth separate treatment. It involves the position of parties who have failed to expressly define what is to happen in the event the third party offer is wholly or partly made up of non-cash consideration. An obvious strategy to circumvent a basic right of first refusal is to arrange for the third party offer to contain consideration that is unique or in some respect unmatchable by the holder of the right.[46] For example, the offer might include as consideration an original work of art, a unique piece of property or even an "old hat".[47] The right will be triggered, but the holder will be unable to replicate the offer. If this were generally permitted, a great number of rights of first refusal would be ineffectual as against a vendor and third party determined to complete their sale by manipulation of the consideration. Yet it seems that there now may be scope for just this sort of mischief.

Until very recently, the Anglo-Canadian default position appeared to be that the vendor was obligated to specify a cash equivalent for any non-cash consideration the vendor was prepared to accept.[48] This was the view ostensibly taken by the English Court of Appeal in *Manchester Ship Canal Company* v. *Manchester Racecourse Company*.[49] A vendor could bargain with the third party for non-cash consideration, but that consideration was to be valued in money terms for the purposes of the operation of the right of first refusal.[50] The default position became somewhat less clear, however, with the judgment of the Ontario High Court in *Baggots Brass Beds Ltd.* v. *Neal Leasing Inc.*[51] There the court took the opposite view, finding that an equivalent cash offer by the holder did not comply with a good faith third party offer of cash and land. The court came to this conclusion apparently without considering the *Manchester*

[45] *Supra* footnote 43 at 312 (Dist. Ct.). The U.S. position on relief is somewhat unclear. In *Texas State Optical, Inc.* v. *Wiggins*, (882 S.W. 2d 8 at 11 (Tex. App. 1994)) a majority of the Texas Court of Appeals accepted the view that a holder of a right of first refusal is not required to comply with terms in the offer which "are not commercially reasonable, are imposed in bad faith, or are specifically designed to defeat the option holder's rights."

[46] Borgerson & Dolan, *supra* footnote 6 at 38-40; Keefe, *supra* footnote 6 at 21-22; Kutzschbach, *supra* footnote 6 at 21-22; Minter & Wacker, *supra* footnote 6.

[47] See *Weber Meadow-View Corporation* v. *Wilde*, 575 P. 2d 1053 (Utah 1978). Also see *C. Robert Nattress & Associates* v. *CIDCO*, *supra* footnote 43 at 43.

[48] See Smith & Denstedt, *supra* footnote 5 at 73-74.

[49] *Supra* footnote 34.

[50] *Ibid.* at 50. It is unclear whether the vendor was *required* to present a cash offer to the holder.

[51] (1989), 4 R.P.R. (2d) 316 (Ont. H.C.).

case. Instead, Southey J. adopted the approach taken in a line of American decisions.[52]

The American approach initially prefers the interests of the vendor by requiring the holder essentially to comply with the third party offer of non-cash consideration.[53] In *Matson* v. *Emory*, the one American case cited in *Baggots*, the Washington Court of Appeal stated that "[a]llowing a cash offer to be the equivalent of the property exchange offer, regardless of the factual situation, imposes a different contract on the parties and seriously infringes on the owner's right to dispose of the property".[54] At the same time, however, American courts do appreciate the potential mischief associated with their default rule. They seek to regulate this mischief by imposing a duty of good faith on the vendor.[55] This duty is then given content, elliptically, by specifying that it is satisfied if the vendor can articulate a "reasonable justification"[56] for insisting on the unique consideration.[57]

In *Baggots*, Southey J. assumed "that these reasonable [American] propositions are also the law of Ontario" and, further, that "[i]f not, I am sure that our law would not be more favourable to the holder of a right of first refusal".[58] These remarks amount, however, to little more than a guess. The issue is plainly somewhat more difficult than Southey J. believed. There are plausible arguments supporting both positions.[59] The problem of immediate concern is the

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[52] See *Prince* v. *Elm Investment Co., Inc.*, 649 P. 2d 820 (Utah 1982); *Matson* v. *Emory*, 676 P. 2d 1029 (Wash. App. 1984); *West Texas Transmission, L.P.* v. *Enron Corporation*, 907 F. 2d 1554 (5th Cir. 1990), cert. denied, 915 F. 2d 695. Also see *Texas State Optical, Inc.* v. *Wiggins*, *supra* footnote 45.

[53] Minor or insubstantial variations may be allowed. See *West Texas Transmission, L.P.* v. *Enron Corporation*, *supra* footnote 52 at 1565-66.

[54] *Supra* footnote 52 at 1032.

[55] See *Prince* v. *Elm Investment Co. Inc.*, *supra* footnote 52 at 824-26; *Matson* v. *Emory*, *supra* footnote 52 at 1032.

[56] Imposing a duty of good faith and then defining it as a duty to provide a "reasonable justification" shifts the onus to the vendor but leaves open the question of what is reasonable. Note further that the "good faith" notion applied here has no apparent independent content; it is but a label for the duty to provide a reasonable justification.

[57] Merely asserting the uniqueness of an offer is not a reasonable justification. But it may be sufficient, for example, that a vendor has a preference for a house included in the offer which will be used as a personal residence. If it is to be used a rental property, on the other hand, an explanation in "commercial terms" may be required. In *Prince* v. *Elm Investment Co. Inc.*, *supra* footnote 52, it was an insufficient justification *per se* that the vendor preferred the offer of partnership of the vendor to that of the holder.

On a more abstract level, one may question the view that the vendor is entitled to insist (with a reasonable justification) on a particular consideration. The grant of the first refusal by the vendor and the subsequent desire for a unique property on the part of that same vendor are unconnected in any relevant way except, arguably, in the sense that the former constrains the latter because it was agreed that the vendor's ability to convey the subject property to third parties would be rendered contingent.

[58] *Supra* footnote 51 at 322.

[59] The issue appears to depend, in large part, on one's view of the sufficiency of the good faith/reasonable justification concept to regulate the mischief of manipulating the consideration to defeat the right of first refusal.

uncertainty that now exists over what constitutes the default rule in Canada. Essentially, because the authorities conflict, there is currently *no* rule, resulting in the loss of any efficiencies associated with the existence of an ascertainable default position. The strategic implication is that it is for the party to whom it matters to explicitly negotiate how mixed or non-cash offers will be handled.[60]

(c) *Renewal*

Reference was made earlier to the lapse or termination of rights of first refusal.[61] For the most part, there is little controversy with respect to the expiry of these rights. The main concern has to do with renewals. As a separate contract, a right of first refusal would be renewed or extended according to its terms. When contained in a lease, however, a curious default position obtains. The rule in Canada is undoubtedly that, absent direct reference to its continuation, a right of first refusal expires at the end of the original term and is not available to an overholding tenant *nor renewed by a general renewal of the lease.*[62] This position is ostensibly based on the principle that a right of first refusal is a separate agreement distinct from the tenancy and thus does not extend beyond the original term without specific provision.

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[60] For the holder, this will likely mean insisting on a term requiring the vendor to extend an equivalent cash offer, subject to arbitration of the value of the non-cash consideration. On the vendor's side, it may be enough simply to avoid the word "price" in the clause, adopting instead the requirement for the holder to strictly satisfy the same "terms and conditions" offered by the third party. See, for example, the discussion in *West Texas Transmission, L.P.* v. *Enron Corporation*, *supra* footnote 52 at 1564. The prospect of a unique consideration is handled in the Canadian Association of Petroleum Landmen 1981 Operating Procedure in the following way:

> If the consideration stipulated in the offer for the subject interest is one which cannot be matched in kind by the offerees, the selling party may set out in its notice its bona fide estimate of the value in cash of the said consideration. If the selling party's notice did not include its bona fide estimate as aforesaid, the offerees, or any of them, may request such estimate in which event the notice period shall be suspended until such estimate is received by all of the offerees. In case of dispute as to the reasonableness of the estimate, the matter shall be referred to arbitration under the provisions of the *Arbitration Act* or *Ordinance* of the province, state or territory where the joint lands are situated, but the notice period shall not be extended by such referral of the dispute to arbitration. If the equivalent cash consideration determined by the arbitration is lower than the estimate submitted by the selling party, the cash consideration determined by arbitration shall be the sale price for the subject interest and the accounts of the selling party and the buying parties shall be adjusted accordingly; if the equivalent cash consideration determined by arbitration is higher than the estimate submitted by the selling party, the estimate submitted by the selling party shall be the sale price for the subject interest.

[61] See *supra* text accompanying footnotes 13, 16-17. Rights of first refusal will tend to lapse or terminate on defined dates or events or, where personal to the holder, on the death of the individual.

[62] *Sherwood* v. *Tucker*, [1924] 2 Ch. 440 (C.A.); *Budget Car Rentals Toronto Ltd.* v. *Petro-Canada Inc.*, *supra* footnote 3. For a summary of the approach taken in the American cases, see the annotation at 15 ALR (3d) 470.

The second part of this proposition, that automatic renewal of a lease does not extend the right of first refusal, was accepted by the Ontario Court of Appeal in *Budget Car Rentals Toronto Ltd.* v. *Petro-Canada Inc.*[63] However, this particular default rule is in no sense an inevitable or necessary conclusion.[64] It rather seems that the rule was fashioned on an abstraction of doubtful practical relevance and contrary to standard conceptions of what constitutes satisfactory contractual language. When it is considered that a right of first refusal is usually employed in a lease relationship to protect the lessee against contractual associations with strangers, it should be plain that the general words of renewal invariably reflect an intention to renew the right of first refusal along with the tenancy. As it stands, a lessor may take advantage of the default rule, agreeing to a general renewal which the lessee believes continues the right of first refusal but which the lessor knows will fail to carry the right of first refusal beyond the original term of the lease. For the lessee who holds a right of first refusal in a renewable lease, this is one instance where even comprehensive contractual language and common sense will not avoid the effects of a failure to comprehend the default position.

(d) *Assignment*

A right of first refusal is a contractual right, rather than an interest in land, and is governed by the general law of assignment relating to choses in action.[65] Accordingly, the first issue is whether the right was intended to be personal to the holder and, as such, not assignable.[66] If not personal, the right is said to be capable of assignment.

When dealing with a lease, an issue arises as to whether a general assignment of the lease, without specific reference to the right of first refusal, is sufficient to carry the right to the assignee. The argument is that the right of first refusal does not pass either because (1) only *in rem* rights are transferred or because (2) it is a separate agreement requiring a specific assignment. The former proposition was rejected in *Re Meewasin Valley Authority and Olfland Land Co. Ltd.*, where the court held that the intention of the parties was to allow

[63] *Supra* footnote 3.

[64] It is possible to distinguish between the renewal and overholding situations. See *Law-Woman Management Corporation* v. *Peel (Regional Municipality)* (1991), 17 R.P.R. (2d) 62 at 83 (Ont. Gen. Div.). Also consider H.S. Silverman, "Commercial Leases, Rights of First Refusal and Reasonable Expectations: A Case Comment on *Budget Car Rentals Toronto Ltd.* v. *Petro-Canada Inc.* " (1990), 10 R.P.R. (2d) 180.

[65] As to the assignment of contractual rights, see G.H. Treitel, *Law of Contract*, 8th ed. (London: Sweet & Maxwell, 1991) at c. 16; G.H.L. Fridman, *Law of Contract*, 3rd ed. (Toronto: Carswell, 1994); Megarry & Wade, *supra* footnote 35 at 759-60; Perell, *supra* footnote 5. Also see L.H. Elphinstone, "Assignment of the Benefit of Covenants Affecting Land" (1952) 68 L.Q.R. 353. For the American position, see Cooney & Ausherman, *supra* footnote 6 at 21.

[66] See Treitel, *ibid.* at 597-98.

the right to pass upon a general assignment of the leasehold.[67] The second basis for the argument was addressed by Lane J. in *Law-Woman Management Corporation* v. *Peel (Regional Municipality)*.[68] The argument was founded, by way of analogy, on the problematic holding in *Budget Car Rentals Toronto Ltd.* v. *Petro-Canada Inc.* that a renewal clause omitting specific reference to a right of first refusal did not carry the right into the renewal term.[69] Lane J. first noted that an ordinary person would assume that the general language of the assignment carried the right of first refusal to the assignee of the lease.[70] He pointedly observed that "[t]he law laid down in *Budget* creates a trap for the unwary when renewing a lease, and I should be reluctant by a mere analogy to open the jaws of the trap wider still so as to capture unwary assignees".[71] The judge then gave effect to this reluctance by distinguishing the *Budget* decision. Referring to a number of English authorities,[72] Lane J. concluded that where the parties indicated in the lease that the right was assignable, a general assignment of the lease would be sufficient to convey the right to the assignee.[73] Such an agreement was present in the case before him, where the lease defined the term "lessee" as including "assigns". Presumably the same result would follow in another case where the terms of the lease were assignable pursuant to a general assignment clause or were "binding upon the parties hereto, their successors and assigns".[74] Given the prevalence of such clauses or phrases, there may be little room left for the operation of the mischievous effects of the *Budget* case in this particular respect.

As it is, the apparent (but precarious) default position in Canada currently seems to be that a right of first refusal will not pass without a specific reference to assignment in the lease itself or in the contract of assignment.[75] In one sense, this merely takes us back to the original question of whether or not the right is intended to be personal to the holder. The lack of reference to assignability in the lease could be considered evidence that the right of first refusal was intended only to be personal.[76] Apart from that, it will be appreciated that this default

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[67] *Supra* footnote 41.

[68] *Supra* footnote 64.

[69] See text accompanying footnote 62 *supra*.

[70] *Supra* footnote 64 at 77.

[71] *Ibid.* at 78.

[72] Eg. *Griffith* v. *Pelton*, [1958] Ch. 205 (C.A.), *Batchelor* v. *Murphy*, [1925] Ch. 220 (C.A.). Consider *Re Button's Lease*, [1964] 1 Ch. 263 and *Roberts* v. *Hanson* (1981), 19 R.P.R. 41 at 50 (Alta. C.A.).

[73] *Supra* footnote 64 at 80-81.

[74] *See Re Meewasin Valley Authority and Olfland Land Co. Ltd.*, *supra* footnote 30 at 734 (Q.B.); *Royal Bank of Canada* v. *Loeb Inc.*, [1995] O.J. No. 1702 (Ont. Gen. Div.) (QL). Also see *Canadian Pacific R.W. Co.* v. *Rosin* (1911), 2 O.W.N. 610 (H.C.).

[75] See *Royal Bank of Canada* v. *Loeb Inc.*, *supra* footnote 74. As to the preferred default position, see the case comments at [1957] C.L.J. 148; (1957), 73 L.Q.R. 452 and (1964) 80 L.Q.R. 21.

[76] Consider *Canadian Pacific R.W.Co.* v. *Rosin*, *supra* footnote 74 at 612; *Mazzeo* v. *Kartman*, *supra* footnote 30 at 738.

position does allow for a measure of opportunistic contracting by the vendor. By avoiding any reference to the potential assignability of the right of first refusal in the lease (where this does not otherwise impair the lease) and by using only general language in the assignment, it may be that the right of first refusal will not pass.[77] This will be a surprising result to the lessee and the assignees of the lessee who neglected to inform themselves of the extant default position.

(e) *Gifts of the Subject Property*

The standard triggering event associated with rights of first refusal is the willingness of the vendor to sell or to accept an offer to sell. The question will therefore arise as to whether a "sale" has been proposed or has occurred. This is arguably the most intricate and certainly the most common issue arising with respect to rights of first refusal and, consequently, the "sale" abstraction carries a great deal of freight in this area.[78] Although not always warranted by the language of the parties, or even conceptually relevant, the courts have generally treated this as the basic issue and it is convenient to adopt the same approach here.[79] This is done subject to the caveat that the primary inquiry will always be whether the event that occurred is an event contemplated by the language employed in the particular provision under consideration. Subject to that qualification, the task of defining the content of the default regime is now pursued through an examination of the judicial sense of what constitutes a "sale" for the purposes of the standard right of first refusal. The first of several specific questions is whether a gift of the subject property to a third party is a triggering event.

There is a sharp divergence between Anglo-Canadian and American authorities on the gift issue. The American position is that, subject to contrary expression, a gift does not trigger a right of first refusal. In *Isaacson* v. *First Security Bank of Utah*, where the vendor transferred the subject property to his son for one third of its value, the court concluded that no sale had taken place because the benefit to the son indicated the vendor's "desire to *give* and not to *sell* the property."[80] Taking into account the reduced consideration actually paid by the son, the court found that the transfer to him "was *more* of a gift than a sale".[81] The court went on to observe that this result did not mean that the property was "placed beyond the lessees' reach" since the right of first refusal

[77] Alternatively, the vendor might employ innocuous terminology that may indicate to a court that the right was intended to be personal, with any general references to assignability being limited to the tenancy. See *Re Sutherland*, *supra* footnote 29 at 442.

[78] One American court has attempted to craft a general definition of "sale" to accommodate or "harmonize" the results of the decided cases. See *Prince* v. *Elm Investment Co., Inc.*, *supra* footnote 52, and *infra* text accompanying footnotes 132-35.

[79] See Sellingsloh, *supra* footnote 6 at 38-40.

[80] 511 P. 2d 269 at 272 (Idaho 1973) [original emphasis].

[81] *Ibid.* [emphasis added].

was carried with the gift and the donee was subject to it upon a future sale.[82] In other gift cases, the courts have negated the right of first refusal by taking the view that a "sale" normally requires an exchange of consideration (which is more than nominal) or an arm's length dealing with the property.[83]

There is little offered by way of justification for this default rule in the American cases. A number of the decisions are explicitly or implicitly premised on a familial connection between the vendor and the donee, and yet the courts involved provide no explanation as to why this should matter.[84] Another consideration put forward is the prospect that the holder could acquire the subject property at no cost if a right of first refusal were triggered by a gift.[85] However, it is unnecessary to conclude that a gift will activate a right of first refusal. Rather, it is enough to prohibit the making of a gift on the basis of the undertaking implicit in the grant of the right that the vendor will not alienate the property except subject to the first refusal of the holder. In other words, this would simply be a matter of properly designing the default rule to disallow gifts, rather than have them trigger the right of first refusal. The effect of this implied term is merely to disable the vendor from making a gift of the property *in specie*. The vendor remains free to make a gift of equivalent value by donating the monies received from the sale of the subject property. The vendor is also free *ex ante* to negotiate the exclusion of gifts from the operation of the right of first refusal.

There are other reasons to reject the American approach. Even where the right of first refusal is carried with the gift, the current default rule would allow the vendor and donee to structure all kinds of arrangements whereby the "gift" would actually represent payment for antecedent or subsequent reciprocal "gifts" or other indirect or covert considerations. Moreover, even if the transfer were a true gift, it seems odd that a volunteer should be favoured over one who has purchased the first refusal. It is also worth observing that a gift exception is inconsistent with the standard rationales, appreciated by both the holder and vendor, for taking a right of first refusal in the first place - whether that is to eventually acquire the property or, in the case of a lease or other relationship, to protect against being forced into contractual associations with new parties.[86]

Essentially the American courts pre-determined the gift issue by asking, exclusively, the "sale" question. Obviously a gift is not a sale. However, that

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[82] *Ibid.*

[83] *Rainbow Oil Company* v. *Christmann*, 656 P. 2d 538 (Wyo. 1982); *Bennett* v. *Dove*, 277 S.E. 2d 617 (W. Va. 1981); *Exeter Exploration Company* v. *Fitzpatrick*, 661 P. 2d 1255 (Mont. 1983); *Perritt Company* v. *Mitchell*, 663 S.W. 2d 696 (Tex. App. 1983); *Mericle* v. *Wolf*, 562 A. 2d 364 (Pa. Super. 1989).

[84] *Isaacson* v. *First Security Bank of Utah*, *supra* footnote 80; *Bennett* v. *Dove*, *supra* footnote 83; *Exeter Exploration Company* v. *Fitzpatrick*, *supra* footnote 83; *Perritt Company* v. *Mitchell*, *supra* footnote 83 ("friendship" was an insufficient connection).

[85] *Exeter Exploration Company* v. *Fitzpatrick*, *supra* footnote 83 at 1259.

[86] Consider the effect of this default rule if it were to apply to rights of first refusals held by partners or by shareholders in close corporations.

analysis misses the mark. The proper question is whether the parties intended a gift of the property to be excluded from the application of the right of first refusal. In the absence of their specific expression of this intent, the pre-existing default rule may be taken as their intention. The default rule will itself have been constructed on the basis of a communal consensus of what is reasonable and socially efficient in the circumstances. Given the considerations addressed above, a reasonable default rule would be that a gift violates a right of first refusal and is therefore impermissible, unless otherwise expressly agreed between the parties.[87] This is essentially the default position defined by the Anglo-Canadian jurisprudence. In *Gardner* v. *Coutts & Company*, the vendor had made a gift of the subject property to his sister[88] without offering it to the holder of the right of first refusal.[89] Cross J. determined that "it is implicit in a grant of first refusal that the person who has to offer the property to the other party should not be entitled to give it away without offering it and so to defeat the first refusal."[90] This approach was adopted in Canada in *Trinity College School* v. *Lyons*, a case involving a gift of property to the daughters of the vendors.[91] Sheard J. implied the same term (prohibiting the gift) in order to "maintain the business efficacy of the transaction in accord with the apparent intention of the parties".[92] This default position is a reasonable one and there appears to be no substantial reason to prefer the American default rule.

(f) *Amalgamation/Merger*

It would seem that business combinations effectuated by voluntary transfers will *prima facie* trigger or violate rights of first refusal associated with the subject property.[93] This will not be the case, however, where the combination is carried out under statutory amalgamation provisions. The difference arises because the legislation accomplishes the combination without a transfer of property. Under the *CBCA*, for example, no "sale" occurs in the course of an amalgamation.[94] Rather, the effect of the certificate of amalgamation is that "the property of each amalgamating corporation continues to be the property of the amalgamated corporation."[95] The same reasoning is applied to mergers under American statutes.[96] In *Torrey Delivery, Inc.* v. *Chautauqua Truck Sales and*

[87] Finding a violation (rather than an activation) of the right is an approach adopted for other types of transactions. See "package sales" and "options" *infra*.

[88] Negating, by the result in the case, the narrower version of the exception associated with familial connection.

[89] [1968] 1 W.L.R. 173 (Ch. D.).

[90] *Ibid.* at 179.

[91] *Supra* footnote 33.

[92] *Ibid.* at 100.

[93] See, for example, the discussion of package sales, *infra*.

[94] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.

[95] Sec. 186(b).

[96] Merger is the American term for amalgamation. See *infra* footnote 256.

Service, Inc. the applicable legislation stated that the property vested in the merged entity "without further act or deed".[97] The court observed that the merger did not involve "divesting or separating control of the subject property" from the vendor and therefore there was no sale or proposed sale.[98] Coincidentally, for the same reason, the right of first refusal would continue to burden the property now held by the merged entity.

(g) *Dissolution*

In the United States, it would appear that an *in specie* distribution of property to shareholders made in the course of the dissolution of a corporation is not a "sale". In *Midland Container Corporation* v. *Sophia Realty Corporation*, the local legislation applicable to a non-judicial dissolution allowed the corporation either to "sell" its assets to third parties or, alternatively, to distribute its assets in kind to shareholders.[99] The court concluded that the "foregoing language unequivocally evinces an intent that the outright distribution of remaining corporate assets to the shareholders themselves is not legally synonymous with a `sale' of those same assets to third parties".[100] Therefore, in the court's view, as a matter of law such a distribution did not trigger a right of first refusal. The same disposition alternatives upon a dissolution are found in Canadian corporation statutes. For a voluntary dissolution under the *CBCA*, for example, a corporation is required to "proceed to collect its property, *to dispose of properties that are not to be distributed in kind to its shareholders*, to discharge all of its obligations and to do all other acts required to liquidate its business".[101] Accordingly, if the American analysis is adopted, the same default rule will apply in Canada.[102]

The default position outside the corporate context is unclear. In *Linden Boulevard, L.P.* v. *Elota Realty Company*, the New York Supreme Court relied on *Midland Container* to deny that a right of first refusal was triggered by a sale between a partnership and one of its partners "as the sale was part of the dissolution of the partnership according to the partnership agreement."[103] It is unclear, however, whether the court did in fact apply or appreciate the distinction made in *Midland Container* between a sale and a distribution in kind. While the court stated that the sale was part of a dissolution "according to the partnership

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[97] 366 N.Y.S. 2d 506 at 511 (App. Div. 1975).

[98] *Ibid.*

[99] 410 N.Y.S. 2d 638 (App. Div. 1978); Also see *Kings Antiques Corp.* v. *Varsity Properties, Inc.*, 503 N.Y.S. 2d 575 (App. Div. 1986).

[100] *Ibid.* at 640.

[101] *Supra* footnote 94, sec. 211 (7)(c) [emphasis added].

[102] In *McCarter* v. *York County Loan Company* (1907), 14 O.L.R. 420 (H.C.), the liquidator chose the first alternative, selling the subject property to a third party (rather than making a distribution in kind), and this triggered the right of first refusal.

[103] 601 N.Y.S. 2d 949 at 951 (App. Div. 1993).

agreement", there is no indication in the case that this was a distribution in kind.[104] It may have been a negotiated sale with an agreeable partner (as the form of the transaction suggested) to cash out an asset prior to a final cash distribution to the partners. Nevertheless, the case does offer some support for the default proposition that a distribution in kind upon the dissolution of a non-corporate structure is not a sale and therefore will not trigger a right of first refusal affecting the distributed property.[105]

(h) *Transfer of Shares*

Although it effectively transfers the subject property, the sale of some or all of the shares of a corporate vendor does not trigger a right of first refusal.[106] This is a natural consequence of separate entity status. The subject property is owned by the corporation both before and after the transfer of its shares. As the court in *Torrey Delivery* put it: "Ownership of capital stock being distinct from ownership of corporate property, it follows that the sale of such stock is not a sale of corporate property."[107] This is a basic proposition, but one routinely ignored by prospective holders in negotiating their right of first refusal. Typically, the right is made to apply only to a sale *by* the vendor corporation and not to a sale of the shares of the vendor corporation itself. This is unsatisfactory even where the subject property represents a small part of the corporate assets, because any change of control over the subject property can adversely affect the holder. Of particular concern in this respect is that *ex ante* the vendor might place the subject property in a corporation having no other assets simply to be in a position to take advantage of this default rule.[108] By doing so, the vendor

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[104] *Ibid.*

[105] Query the effect of the aggregate notion of partnership and the division of legal and equitable estates in a trust. Consider also what conceptual difficulty may arise where, for example, the distribution out of a dissolving partnership or trust is not consistent with the prior beneficial interests of the partners or beneficiaries.

[106] *Torrey Delivery, Inc.* v. *Chautauqua Truck Sales and Service, Inc.*, *supra* footnote 97; *Cruising World, Inc.* v. *Westermeyer*, 351 So. 2d 371 (Fla. App. 1977); *K.C.S. Ltd.* v. *East Main Street Land Development Corporation*, 388 A. 2d 181 (Md. App. 1978); *LaRose Market, Inc.* v. *Sylvan Center, Inc.*, 530 N.W. 2d 505 (Mich. App. 1995). Unless perhaps it is one of a series of steps designed to circumvent the right of first refusal. See *GATX Corp.* v. *Hawker Siddley Canada Inc.*, *supra* footnote 4 and the discussion at *infra* footnote 241.

The converse proposition, that a sale of *assets* does not trigger a right of first refusal affecting the *shares* of the corporation, is also established by the cases. See *Helfand* v. *Cohen*, 487 N.Y.S. 2d 836 (App. Div. 1985); *Power Test Petroleum Distributors, Inc.* v. *Baker-Tripi Realty Corp.*, 594 N.Y.S. 2d 266 (App. Div. 1993); *Frandsen* v. *Jensen-Sundquist Agency, Inc.*, *supra* footnote 42.

[107] *Supra* footnote 97 at 510.

[108] The vendor might instead reserve the ability to incorporate the subject property by excluding from the ambit of the right of first refusal any transfer to an "affiliate". See *GATX Corp.* v. *Hawker Siddeley Canada Inc.*, *supra* footnote 4, where such a reservation was utilized as part of a step transaction.

would effectively retain the power to sell either to the holder of the right or to the third party, subject only to the usual considerations to be addressed in choosing between a sale of shares and a sale of assets. Accordingly, prospective holders must address this possibility in the contract. Where interests in other structures are involved (for example, trusts, partnerships), and where the default rule is unclear, it is equally important for the holder to negotiate the extension of the right of first refusal to sales of interests in that structure (for example, trust units, partnership interests).[109]

(i) *Sale of a Portion of the Subject Property*

In *Pushka* v. *Magnowski Estate*, the vendor argued that a right of first refusal in a lease covering three parcels of land applied only to a third party offer for all three parcels together.[110] The Manitoba Court of Appeal instead construed the right of first refusal to apply "to all three parcels together, or the individual parcels".[111] Consequently, a sale of only one of the three parcels did trigger the right of first refusal. This seems a sensible default rule for the typical provision. As the trial judge in *Pushka* observed, if a sale of one of the parcels did not trigger the right, neither would a sale of either or both of the remaining two, thus wholly defeating the right of first refusal by piecemeal disposition.[112] The American position on sales of portions of the subject property is unclear.[113]

(j) *Transfer of Interest to Joint Owner*

The American courts take the view that transfers between co-owners do not trigger a right of first refusal.[114] Different explanations have been offered for this default rule. In *Rogers* v. *Neiman*, where undivided ownership interests were conveyed between tenants in common who had previously leased the property, the court thought "the proper construction of the lease was that an option existed only if the entire property was offered for sale by all of the

[109] The applicability of the corporate analysis to non-corporate structures would depend, presumably, on whether a similar dissociation between the interest in the property and the interest in the structure can be established. This may involve an extended and complex analysis of the nature of the given structure.

[110] (1984), 26 Man. R. (2d) 89 (C.A.).

[111] *Ibid.* at 93.

[112] (1983), 23 Man. R. (2d) 189 at 194 (Q.B.). The same observation was made in *Colonie Motors, Inc.* v. *Heritage Corporation of New York*, 403 N.Y.S. 2d 574 at 576 (App. Div. 1978).

[113] The American cases on package sales are perhaps conceptually most closely related to sales of parts of the subject property (see text on package sales, *infra*).

[114] Cf. *Meyer* v. *Warner*, 448 P. 2d 394 (Ariz. 1968). Also see *Hawthorne's, Inc.* v. *Warrenton Realty, Inc.*, *supra* footnote 19 at 912 (footnote 4).

lessors".[115] But arguably this is too wide a proposition and certainly went beyond what was required for the decision in the case. Taken literally, the proposition would excuse transfers of partial ownership interests to third parties. It is also open to the criticism mentioned above in connection with transfers of portions of the subject property. If accepted, a right of first refusal could be completely circumvented by serial transfers of partial ownership interests.[116] A narrower explanation is found in the subsequent cases of *Byron Material, Inc.* v. *Ashelford*[117] and *Wilson* v. *Grey*,[118] which also concerned the sale of undivided interests between co-owners. Both courts were of the view that there was no "sale" within the terms of the respective rights of first refusal unless the conveyance was to a person other than those in the original lessor or vendor group. In each case, the transfer occurred within the original owner group. Although a narrower analysis, it is of doubtful general utility, representing, as it does, no more than the idiosyncratic construction of specific words of the right of first refusal.[119] The important fact is that the transaction clearly results in a change of ownership and control of the property. The effect of it is shown, quite unintentionally, by the statement of the court in *Byron Material* that "the lessee herein has neither gained nor lost by this transfer within [the group of co-owners]".[120] Obviously the lessee *has either gained or lost*, depending on how the ownership change (usually a concentration of ownership) will affect the lessor/lessee relationship. This kind of change, potentially calamitous for the lessee, is exactly the sort of event a right of first refusal in a lease is designed to address.[121] What Canadian courts will do in similar circumstances remains to be seen.[122]

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[115] 193 N.W. 2d 266 at 267 (Neb. 1971). Also see *Lyman* v. *Jennings*, 637 P. 2d 259 (Wyo. 1981); *Baker* v. *McCarthy*, 443 A. 2d 138 (N.H. 1982). In the latter case (at 141), the court stated that "[a] sale to a third party by all of the grantors was clearly intended, and the plaintiff's right of refusal was not intended to be used to make the plaintiff a tenant in common with any of the grantors". While the intention was by no means clear, the consequence of triggering the right was at least a relevant consideration. Note that this consideration is essentially a reversal of the traditional notion that rights of first refusal are intended to protect the *holder* against unwanted contractual associations. Note further that co-tenants are already protected against unwanted associations through the availability of a partition action. They may also acquire protection *ex ante* by themselves agreeing to rights of first refusal with respect to any sale by one of their group. On this latter possibility, see *Shiver* v. *Benton*, 304 S.E. 2d 903 (Ga. 1983) and *Gore* v. *Beren*, *supra* footnote 30.

[116] *Supra* footnote 112.

[117] 339 N.E. 2d 26 (Ill. App. 1975). Also see *Texas Co.* v. *Graf*, 221 S.W. 2d 865 (Tex. App. 1949).

[118] 560 S.W. 2d 561 (Ky. 1978).

[119] See the opposite interpretation offered by the Court of Appeal in *Grey* v. *Wilson*, 554 S.W. 2d 867 (Ky. App. 1977).

[120] *Supra* footnote 117 at 29.

[121] See, in this regard, Borgerson, *supra* footnote 6 at 31-33. Also, in *Baker* v. *McCarthy*, *supra* footnote 115 at 141, the court found comfort in the fact that the "transaction among the grantors did not add third parties to the ownership picture who would adversely affect the plaintiff's rights contemplated by the provisions of her deed". But query, for example, the position of a holder who, as lessee, is subjected to an entirely different relationship when an objectionable minority owner takes full control of the property.

[122] No Canadian cases dealing with a right of first refusal were found.

(k) *Change of Form*

The American courts have also excused transactions which involve the vendor changing the form or structure through which the subject property is held.[123] The judges *assume* that an arm's length transaction is required and then find that no "sale" occurs where the vendor owns or controls the form to which the subject property is transferred. In *Sand* v. *London & Company, Inc.*, the court observed that there was "nothing about the negotiations of the parties to suggest arms' length dealing between an owner willing (but not forced) to sell, and a buyer willing (but not forced) to buy, which usually characterizes an open market sale."[124] It concluded that the transfer between two corporations controlled by the same persons did not trigger the right of first refusal because its "language intended a transmutation whereby the lessor would dispose of the property for value to a third person and cease to have any further interest in it".[125] The particular language of the *Sand* right of first refusal was in fact the typical language, referring simply to a "sale" without any qualification.[126] The *Sand* court, in effect, added words to the parties' agreement by requiring an "arm's length" transaction. This was done, moreover, without any explanation of what justified this implied qualification. The motives for the transfer (financial and organizational) were mentioned, but those considerations are irrelevant to the question of whether the transfer was subject to the right of first refusal. Notwithstanding its weak foundation and contrary authority in a similar case,[127] the *Sand* decision was subsequently applied in *Kroehnke* v. *Zimmerman*.[128] The court in this case refused to find a "sale" where lessors transferred their property to a family corporation. Here, as in *Sand*, there was no analysis beyond the statement that there was nothing in the record to suggest an arm's length dealing.[129] At the same time, however, the court appeared to limit or qualify this "change of form" rule by tying it to a property management motive. There was no "sale" in the circumstances because it was "solely for the convenience of the lessors in managing the property."[130] But there is no

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[123] Certain changes of form are routinely expressly exempted from the scope of rights of first refusal in the oil and gas context. See *infra* text accompanying footnotes 249-251.

[124] 121 A. 2d 559 at 562 (N.J. Super, A.D. 1956).

[125] *Ibid.*

[126] The provision (at 560) was "If at any time during the existence of this lease or any extension or renewal thereof, the landlord shall receive an offer for the sale of the particular lands demised herein to the tenant named herein, and as above described, and as appears on the sketch annexed hereto, the landlord agrees not to accept such offer or make any contract of sale thereof, without first giving the tenant named herein an option to acquire and purchase said lands upon the same terms and conditions contained in such offer of purchase."

[127] *Swiss-American Importing Company* v. *Variety Food Products Company*, 436 S.W. 2d 770 (Mo. App. 1969).

[128] 467 P. 2d 265 (Colo. 1970). See also *Straley* v. *Osborne*, 278 A. 2d 64 (Md. 1971).

[129] *Ibid.* at 267.

[130] *Ibid.*

connection between the motive for the sale and the interpretation of the right of first refusal. Apart from that, this is an almost inconsequential qualification (ie. property management) because it is relatively easily satisfied by asserting any standard management rationale.

It is at least clear that the exception is not available if the change of form involves the introduction of a new party to a significant control position.[131] In *Prince* v. *Elm Investment Co., Inc.*, the lessor transferred the subject property to a partnership in which it held a 51% interest and in which each of the two partners had a veto over all decisions.[132] The court determined that a "sale" had occurred because of the transfer of "control to an unrelated third party" and that, consequently, the right of first refusal had been triggered.[133]

The other interesting feature of the *Prince* case is the court's attempt to fashion a general default rule defining the characteristics of an excusable change of form. After referring to several of the sale exceptions discussed above, the court concluded that they could all "be harmonized under a single rule: 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".[134] This represents an exception of some breadth and yet there is virtually no analysis in the case of either the analytical sources or the effect of such a rule.[135] This breadth is perhaps partly explained by the fact that the *Prince* court itself found that there *was* a sale. Presumably the court felt bound to assume the widest possible scope for the "change of form" exception before finding that it was not available on the facts of the case. However that may be, the main difficulty with the case, as with the earlier cases, is the failure of the court to provide an analytical foundation for its rule or for any of the authorities it purported to harmonize. Thus, while the actual decision of the court makes sense, the elaboration of the "change of form" exception is extremely problematic.

The *Prince* test was subsequently applied in *Belliveau* v. *O'Coin* to a transfer of the subject property to a corporation controlled by the vendors.[136] The court denied that there had been a conveyance to a "stranger" or that the corporation had "gained substantial control over the property".[137] The holder of the right of first refusal had argued that this conclusion would involve a piercing

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[131] For then it is not simply a change of form. See also *Colonie Motors, Inc.* v. *Heritage Corporation of New York, supra* footnote 112.

[132] *Supra* footnote 52.

[133] *Ibid.* at 823.

[134] *Ibid.*

[135] For example, the exception sets high thresholds of "a significant interest" and "substantial control" [below these thresholds no "sale" to a stranger will be characterized as a "sale" for the purposes of a right of first refusal]. Neither of these thresholds is justified by anything in any of the authorities cited in the case and the court offers no abstract or practical justification of its own.

[136] 557 A. 2d 75 (R.I. 1989).

[137] *Ibid.* at 79.

of the corporate veil.[138] The court denied this, insisting that the conveyance "was a transaction between two separate entities and will be honored as such."[139] Nevertheless, according to the court, the proper construction was that "the defendants' right of first refusal simply does not apply to a conveyance between related, interested parties in circumstances in which that conveyance is made solely for the purpose of managing the property's development."[140] In other words, the parties had supposedly implicitly agreed to this "property management" change of form exception. However, it is unclear what pressing condition necessitated the implication of a term of this kind.

There is no comparable line of cases in Canada and this sort of exception may not appeal to Canadian courts.[141] The issue is whether there is a sound basis for a default rule of this nature. As it is, acceptance of the exception initially requires the court to assume that the "sale" terminology implies an "arm's length sale". It also requires the court to read in the words "for property management purposes". All of this is to be done without the assistance of the identifiable "necessity" normally required to imply terms.[142] Where a corporation is involved, the court must also find as a matter of law, and without statutory authorization,[143] that the corporation did not enter into an arm's length transaction with its shareholders. The Canadian judiciary is more likely to apply the maxim that one must take the burdens of incorporation along with the benefits.[144] There is no substantial reason to depart from this proposition in this instance. It is hardly enough merely to conclude that the conveyance "is made solely for the purpose of managing the property's development".[145] That is simply a statement of the alleged benefit of incorporation. The burden for the vendor, of course, is that by conveying to a separate legal entity, the right of first refusal will be triggered and the holder of the right may choose to take the subject property. The *ex ante* solution to this possibility, as it is generally, is to negotiate an express exception. The *ex post* solution is to obtain a waiver or release from the holder of the right.

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[138] Arguably this was an accurate assessment of the court's analysis. Strictly speaking, as a separate entity, the corporation was a "stranger". To find that the parties were related, the court had to peer behind the corporate facade.

[139] *Supra* footnote 136 at 79.

[140] *Ibid.*

[141] Consider *Farr* v. *Attwood*, *supra* footnote 43, where the issue could have been, but was not, raised in relation to a transfer between a partnership and a related corporation.

[142] The test for implying terms is discussed in *Law-Women Management Corporation* v. *Peel (Regional Municipality)*, *supra* footnote 64 at 81-82.

[143] In Canada, specific statutes deem certain corporations to be "related" to each other for particular purposes. [Eg. *Income Tax Act*, *Competition Act*] Outside these regimes there is no accepted basis for "relating" corporations other than by the usual common law doctrines (eg. agency).

[144] *Constitution Insurance Co. of Canada* v. *Kosmopoulos* (1987), 34 D.L.R. (4th) 208 at 213-14 (S.C.C.).

[145] *Supra* footnote 136 at 79.

(l) *Exchange of Property*

A third party may offer to exchange or trade other property, rather than money, for the subject property. The question will then arise whether an "exchange" of properties is a "sale" for the purposes of the right of first refusal.[146] Although there are few decisions dealing specifically with first refusals, the trend seems to be towards equating the two notions, with the result that an exchange will be regarded as a triggering event.[147] The case illustrating the modern American view is *Anderson* v. *Armour and Company*.[148] There the court dismissed the "exchange" argument as "completely untenable", observing that the subject property was effectively "sold" and placed beyond the reach of the holder of the right of first refusal.[149]

The approach in the United States to this issue generally (ie. outside the right of first refusal context) is marginally more elaborate. The courts usually treat the notions of exchange and sale as interchangeable but accept that there is a technical difference between the two.[150] A sale is a transfer for money, in whole or in part, and includes exchanges valued in money terms. An "exchange" is the limited case of a reciprocal transfer of properties without any pricing. This technical definition of exchange was narrowed even further recently when it was determined that a sale occurs if the subject property is appraised with a view to realizing that amount upon a disposition.[151] A number of observations are relevant here. The first has to do with the ostensible rationale for an "exchange" exception, that the absence of pricing or valuation makes the operation of the right of first refusal difficult or uncertain because there is no clear price at which the holder of the right may purchase the subject property. The argument would be that only transactions proposed by third parties which generate a price or value for the subject property ought to trigger a right of first refusal. The response to this argument is that the nature of the exchange by itself identifies a price formula.[152] It can be assumed, in the absence of a contrary indication, that vendors will dispose of assets for what they believe them to be worth. That, of course, is merely the definition (or evidence) of fair market value. Accordingly,

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[146] The facts that give rise to this issue will often also raise the unmatchable consideration argument. See *supra* text accompanying footnotes 46-60.

[147] See generally Abright, *supra* footnote 6 at 812; Cooney & Ausherman, *supra* footnote 6 at 17-18; Kutzschbach, *supra* footnote 6 at 19-22.

[148] *Supra* footnote 24. See also *Panuco Oil Leases, Inc.* v. *Conroe Drilling Company*, 202 F. Supp. 108 (S.D. Tex. 1961).

[149] *Ibid.* at 89.

[150] *Gill* v. *Eagleton*, 187 N.W. 871 (Neb. 1922); *Gruver* v. *Commissioner of Internal Revenue*, 142 F. 2d 363 (4th Cir. 1944); *Swiss-American Importing Company* v. *Variety Food Products Company*, *supra* footnote 127.

[151] *Fain Land & Cattle Company* v. *Hassell*, 790 P. 2d 242 (Ariz. 1990).

[152] The typical right of first refusal (rather than the exchange) is also by its nature a device intended to allow for the acquisition of the subject property at its fair market value (*ie.* by requiring a *bona fide* third party offer). See *infra* text accompanying footnote 183.

where the vendor has expressed a willingness to trade for some other unpriced property, the price of the subject property to the holder would be its fair market value.[153] The second observation is that the technical definition of "exchange" is quite narrow, and the event is unlikely in practice to occur very often because most exchanges of property incorporate some element of pricing or valuation. A third observation is that most authorities appear to accept that the term "sale" includes within its scope the concept of an exchange.[154] Consequently, to accommodate an "exchange" exception, it would be necessary to read down the sale terminology to encompass less than its ordinary meaning. A fourth observation is that the denial of the exception will avoid the mischief of the vendor and third party conspiring to arrange their transaction as an "exchange" in order to defeat the right of first refusal.

There appear to be no Canadian cases dealing with this issue specifically in relation to first refusals. On the matter generally, there is English[155] and Canadian[156] authority for the existence of a technical distinction similar to that made in the American materials. In other Canadian cases, albeit without much discussion, courts have refused to accept that there is a distinction or that different rules apply to exchanges and sales.[157] The result is that, while there is perhaps a theoretical argument to be made, there is no actual Canadian authority for the proposition that exchanges are not contemplated by the sale terminology in the typical right of first refusal. Also standing in the way of that proposition is the *Anderson* decision[158] and, evidently, the plain meaning of the "sale" language. The better view, it would appear, is that an exchange will activate a right of first refusal.[159]

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[153] As the usual condition is that the vendor receive an offer which is acceptable (which would represent what the vendor believes the subject property is worth), strictly speaking it would be the fair market value of the offered consideration that would define fair market value. Theoretically, of course, this should correspond with the fair market value of the subject property.

[154] The following summary is found at 33 Corpus Juris Secundum, para. 1, p. 5:

> It has frequently been held or stated that there is no substantial difference between a sale and an exchange; and the legal effect of a contract of exchange is generally the same as that of a contract of sale. In both cases the title is absolutely transferred and both transactions are governed by the same rules of law practically. In law an exchange is recognized as two sales or a double sale, and an exchange of real estate is as to each one of the parties a sale and purchase of property.

[155] *Robshaw Brothers Ltd.* v. *Mayer*, [1957] 1 Ch. 125.

[156] *Mason & Risch Ltd.* v. *Christner* (1918), 46 D.L.R. 710 (Ont. S.C.).

[157] *Newberry* v. *Brown* (1915), 23 D.L.R. 627 (B.C.C.A.); *McLeod* v. *Walker* (1889), 28 N.B.R. 550 (S.C.).

[158] *Supra* at footnote 148.

[159] According to *Halsbury's Laws of England*, 4th ed., vol. 41, para. 601: "The law relating to contracts of exchange or barter is undeveloped but courts seem inclined to deal with such contracts as analogous to contracts of sale."

(m) *Package Sales*

A third party may offer to purchase the subject property in a package with other properties.[160] The vendor might then proceed with the sale to the third party without first giving the holder of the first refusal the opportunity to match the terms. Invariably the vendor's argument will be that the first refusal is not applicable because there is no offer for the subject property alone.[161] This argument, however, has been firmly rejected in the United States.[162] Virtually every court that has considered the matter, and there are many, has concluded that a package sale made without first offering the subject property to the holder violates[163] the right of first refusal.[164] The effect of the transaction, if allowed, would be to "impair", "destroy", "defeat" or "nullify" the right of first refusal.[165] Given this clear default position, it is odd that the issue continues to reappear regularly in the American case law. The reason for the puzzling tenacity of this defeated argument likely has little to do with any sort of unappreciated validity and everything to do with remedial consequences.

Whereas there is almost universal agreement that a right of first refusal is violated by a package sale, there is a stark divergence of opinion about what to do in the event that it occurs. It is clear enough that where the sale has not yet taken place, the court will issue an injunction to prevent the conveyance of the subject property.[166] The divergence in the decisions arises when the holder is

[160] The phrase "complex transaction" (also multi-property transaction) is sometimes substituted for the "package sale" terminology. It is clear, however, that the complexity of a transaction does not *per se* afford a basis for excusing compliance with a right of first refusal.

[161] It has also been suggested by Abright, *supra* footnote 6 at 816, that the "the failure to provide a workable formula for applying the right to a package deal is arguably evidence that the parties did not intend the preferential right to apply to such transactions."

[162] The issue has attracted a good deal of interest in the first refusal literature. See Abright, *supra* footnote 6 at 816-18; Borgerson & Dolan, *supra* footnote 6 at 40-44; Conine, *supra* footnote 6 at 1324-25; *Cooney* v. *Ausherman*, *supra* footnote 6 at 16-18; Reasoner, *supra* footnote 6 at 71-78; Sellingsloh, *supra* footnote 6 at 50-57; Smith & Denstedt, *supra* footnote 5 at 72-73; B. Daskal, "Rights of First Refusal and the Package Deal" (1995) 22 Fordham Urban Law J. 461; W.B. Stutzman & D.E. Day, "Protecting the Preemptor: Real Property Rights of First Refusal in Light of *Gyurkey* v. *Babler*" (1983) 19 Idaho L.R. 277.

[163] As will appear shortly, there is a distinction to be made between "violating" and "triggering" a right of first refusal.

[164] See the authorities cited at footnotes 168 and 170, *infra*. The only two exceptions are *Sautkulis* v. *Matzok*, 150 N.Y.S. 2d 356 (App. Div. 1956) and *Crow-Spieker #23* v. *Robert L. Helms Construction and Development Co.*, 731 P. 2d 348 (Nev. 1987). As to the Sautkalis decision, see *Costello* v. *Hoffman*, 291 N.Y.S. 2d 116 (App. Div. 1968).

[165] According to Reasoner (*supra* footnote 6 at 71-72), "It should normally be clear where fee simple interests are involved that the parties did not intend to create a right that could be vitiated merely by grouping the burdened interest with other property in a sale."

[166] *Pantry Pride Enterprises, Inc.* v. *Stop & Shop Companies, Inc.*, 806 F. 2d 1227 at 1229 (4th Cir. 1986).

claiming specific performance of the right of first refusal.[167] The supposed "majority" view is that specific performance will not be granted because the sale of a package of properties does not disclose an intention to sell the subject property separately, even if there is a formal allocation of the bulk price amongst the different pieces of the package.[168] The proper remedy, according to these courts, is simply to reconvey the subject property to the vendor.[169] The opposing view is that specific performance is available because the package sale triggers the first refusal on the subject property.[170] In *Berry-Iverson Co. of North Dakota, Inc.* v. *Johnson*, the court stated that "an intention to sell a larger parcel of land, including a tract under lease to a tenant, is evidence of an intention to sell the leased premises, even where no separate apportionment of value is made by owner and purchaser".[171] According to the court, "[t]o conclude otherwise would permit an owner and prospective purchaser to, in effect, destroy a bargained-for purchase preemption".[172] The courts that take this view will set

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[167] In the absence of an offer to sell just the subject property, the holder will not be taken to have waived the right of first refusal. See *Saab Enterprises, Inc.* v. *Wunderbar*, 554 N.Y.S. 2d 657 (App. Div. 1990).

[168] *New Atlantic Garden, Inc.* v. *Atlantic Garden Realty Corporation*, 194 N.Y.S. 34 (App. Div. 1922); *Smith* v. *Traxler*, 90 S.E. 2d 482 (S.C. 1955.); *L.E. Wallach, Inc.* v. *Toll*, 113 A. 2d 258 (Pa. 1955); *Guaclides* v. *Kruse*, 170 A. 2d 488 (N.J. Super. A.D. 1961); *Aden* v. *Hathaway*, 427 P. 2d 333 (Colo. 1967); *Myers* v. *Lovetinsky*, 189 N.W. 2d 571 (Iowa 1971); *Straley* v. *Osborne*, 278 A. 2d 64 (Md. 1971); *C&B Wholesale Stationery* v. *S. De Bella Dresses, Inc.*, 349 N.Y.S. 2d 751 (App. Div. 1973); *Gyurkey* v. *Babler*, 651 P 2d 928 (Idaho 1982); *Manella* v. *Brown Company*, 537 F. Supp. 1226 (D. Mass. 1982); *K.S. & S. Restaurant Corp.* v. *Yarbrough*, 479 N.Y.S. 2d 235 (App. Div. 1984); *Tarallo* v. *Norstar Bank*, 534 N.Y.S. 2d 485 (App. Div. 1988); *Chapman* v. *Mutual Life Insurance Company of New York*, 800 P. 2d 1147 (Wyo. 1990). Also consider *Shell Oil Company* v. *Trailer & Truck Repair Co., Inc.*, 828 F. 2d 205 (3d Cir. 1987).

[169] The court in *Tarallo* v. *Norstar Bank*, *supra* footnote 168 at 487, concluded that "[t]he proper remedy in a situation such as this, where title to the larger parcel has already passed in accordance with the contract, is to compel a reconveyance of the leased premises and grant an injunction barring their sale to anyone other than the grantee of the option without first offering the leased premises to said grantee".

[170] *Pantry Pride Enterprises, Inc.* v. *Stop & Shop Companies, Inc.*, *supra* footnote 166; *Wilson* v. *Brown*, 55 P. 2d 485 (Cal. 1936); *Brenner* v. *Duncan*, 27 N.W. 2d 320 (Mich. 1947); *Denco, Inc.* v. *Belk*, 97 So. 2d 261 (Fla. 1957); *Maron* v. *Howard*, 66 Cal. Rptr. 70 (Ct. App. 1968); *Garmo* v. *Clanton*, 551 P. 2d 1332 (Idaho 1976); *Berry-Iverson Co. of North Dakota, Inc.* v. *Johnson*, 242 N.W. 2d 126 (N.D. 1976); *Thomas & Son Transfer Line, Inc.* v. *Kenyon Inc.*, 574 P. 2d 107 (Colo. App. 1977), aff'd. 586 P. 2d 39 (Colo. 1978); *Landa* v. *Century 21 Simmons & Co., Inc.*, *supra* footnote 42; *Riley* v. *Campeau Homes (Texas), Inc.*, 808 S.W. 2d 184 (Tex. App. 1991).

As to specific performance with respect to the whole package, see *First Nat. Exchange Bank of Roanoke* v. *Roanoke Oil Co., Inc.*, 192 S.E. 764 (Va. 1937); *Beets* v. *Tyler*, 290 S.W. 2d 76 (Mo. 1956); *Atlantic Refining Co.* v. *Wyoming Nat. Bank of Wilkes-Barre*, 51 A. 2d 719 (Pa. 1947); *Hinds* v. *Madison*, 424 S.W. 2d 61 (Tex. App. 1968).

[171] *Supra* footnote 170 at 134. Also see *Anderson* v. *Armour and Company*, *supra* footnote 24 (package sale triggered right of first refusal).

[172] *Ibid.*

the price for the subject property at its fair market value or a proportionate part of the bulk price.[173]

It should be observed here that, contrary to the usual assertion, there is in fact no "majority" position on this question.[174] There are roughly equal numbers of cases, and states, on either side of the issue,[175] and most of the decisions were rendered with a full appreciation of the conflict in the jurisprudence. The two sides simply focus on, and accommodate with their respective default rules, different concerns. The reconveyance side focuses on the supposed absence of an intent on the part of the vendor to sell the subject property separately and on the lack of agreement on price. The specific performance side regards the transaction as a subversion of the original intent of the parties.

The primary concern of the courts which reconvey the subject property to the vendor appears to be the pricing problem.[176] Prices of even continuous lots, depending on their attributes and development, will vary. As well, the packaging itself can have a dramatic effect on prices. The price of a particular property may increase or decrease because of its association with other contiguous, and even non-contiguous, properties.[177] It is therefore assumed that it is not possible to conclude that the price of the subject property is either its fair market value or a proportionate part of the bulk price. It cannot be said, supposedly, that such a price is demonstrably the price the vendor was "willing to accept". Other courts, however, have not been convinced that these kinds of considerations establish that specific performance is an inappropriate remedy.[178] They regard the pricing problem as the creation of the vendor. A sale was proposed, but the duty of the vendor to set a specific price or not accept a bulk price was breached.[179] This failure by the vendor cannot be used to avoid the operation of

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[173] As to proportionate pricing, see the critical remarks in *Guaclides* v. *Kruse*, *supra* footnote 168 at 494 and *Gyurkey* v. *Babler*, *supra* footnote 168 at 932-33. Also see *Berry-Iverson Co. of North Dakota* v. *Johnson*, *supra* footnote 171 at 135-36.

[174] Numerous commentators and judges have made this assertion. Whether or not there was originally a basis for it, there is none now.

[175] The jurisdictions adopting the position that specific performance is available include California, Colorado, Florida, Michigan, North Dakota, Texas and Virginia. On the other side are Idaho, Iowa, New York (several cases), New Jersey, Pennsylvania and Wyoming.

[176] Pricing considerations are discussed generally in the materials referred to in footnote 162, *supra*. See, in particular, Abright, *supra* footnote 6 at 817.

[177] For example, lot X will command a higher price when packaged with lot Y where these are the only two local lots suitable for a particular type of business (eg. supermarket).

[178] See *Pantry Pride Enterprises, Inc.* v. *Stop & Shop Companies, Inc.*, *supra* footnote 166. Specific performance would be an *inappropriate* remedy, for example, in relation to a third party purchaser who acquired the subject property without notice of the first refusal (See *Peterson* v. *Canadian Imperial Bank of Commerce*, *supra* footnote 43). Note also that, under a Torrens system, unregistered interests do not affect third party purchasers.

[179] *Brenner* v. *Duncan*, *supra* footnote 170 at 322; *Maron* v. *Howard*, *supra* footnote 170 at 79. Also see Reasoner, *supra* footnote 6 at 77 ("owner has manifested an unequivocal intent to sell [and] has no standing to complain of any difficulty in [pricing because] his own wrongdoing has created the difficulty."

the right of first refusal. Accordingly, having accepted that a triggering sale did occur, the only issue for these courts is the proper price for specific performance of the holder's right.

It is worth mentioning at this point that pricing is a problem for the holder in another way. In a package sale, the vendor and third party together or the vendor alone, may formally allocate the price amongst the specific properties in the package. The concern here is that the price of the subject property will be inflated.[180] For example, the vendor and third party may seek to discourage the exercise of the holder's option by assigning a high price to the subject property, recovering the difference as between themselves through lower prices for other parcels in the package. Or the vendor alone may allocate prices based on incentives unrelated to fair market value (eg. tax consequences). These sorts of considerations suggest that, for pricing packaged properties, the fair market value of the subject property is the preferable standard.[181]

It is evident that the American courts have yet to develop a uniform response to the remedy issue. The effect of this is predictable. Vendors and third parties will continue, as they have, to arrange package sales in attempts to circumvent rights of first refusal. They know that this violates the right of first refusal, but they also know that in many states the court will simply order the reconveyance of the subject property to the vendor. They will assume, correctly, in many instances, that the holder is unlikely to incur the costs of litigation to obtain this pyrrhic result.[182] Accordingly, they will achieve their objective, using this default position strategically, at virtually no cost to themselves. These kinds of practical machinations will only be avoided if courts grant specific performance, subject to the usual equitable considerations, as a matter of course. The remedy should be granted and the price to the holder should be the fair market value. This price standard is implicit in the nature of a right of first

[180] This aspect of pricing is formally regulated, at least partially, by the requirement of a *bona fide* offer. See also *Hinson* v. *Roberts*, 349 S.E. 2d 454 (Ga. 1986); *Pantry Pride Enterprises, Inc.* v. *Stop & Shop Companies*, *supra* footnote 166 at 1231-32.

[181] See *Maron* v. *Howard*, *supra* footnote 170; *Pantry Pride Enterprises Inc.* v. *Stop & Shop Companies*, *supra* footnote 166; *Berry-Iverson Co. of North Dakota, Inc.* v. *Johnson*, *supra* footnote 170.

[182] According to Reasoner, *supra* footnote 6 at 77:

> Courts that merely grant rescission and enjoin the owner of the burdened interest from further sales without honouring the preferential purchase right are not making due allowance for the burden of litigation. In a state following this rule, the holder of the preferential purchase right faces the possibility that he will be put to the formidable expense and effort of litigation with the ultimate result that he will receive only the negative benefit of preventing the owner of the burdened interest from making a sale to someone else. Whether he will ever get to exercise his preferential right remains entirely contingent. Where the owner of the burdened interest by his misconduct has forced the owner of the preferential purchase right to litigate, the owner of the right should be allowed to exercise that right as partial compensation for the litigation. Many times, of course, the burdened interest would not be of sufficient value to support any litigation, much less litigation that could give no immediate, positive benefit.

refusal.[183] The parties originally agreed that the price to the holder was to be what a third party would be *bona fide* willing to pay and what the vendor is willing to accept. This is nothing more than an expression of the notion of fair market value. From a different perspective, relating specifically to package sales, the implication of attaching a right of first refusal to a particular property in the first place is that the vendor agrees to forego synergistic gains above the fair market value that might otherwise be available as a result of the structuring or packaging of the sale of the subject property.[184] In the end, it is simply a decision over how best to design the optimal default rule.

Package sales have only recently come before Canadian courts. In the 1989 case of *Budget Car Rentals Toronto Ltd.* v. *Petro-Canada Inc.*,[185] the vendor had sold all of its marketing and refinery assets in eastern Canada for a bulk price of hundreds of millions of dollars without giving the holder an opportunity to purchase the subject property.[186] The Ontario Court of Appeal stated that the

[183] See *supra* text accompanying footnotes 152-53. The bulk price of the *entire* package would presumably be a fair market value. However, because of tradeoffs and synergies, it will not necessarily represent simply an aggregation of individual fair market values.

[184] Although the court itself denied the availability of specific performance, essentially this very implication is found in *Gyurkey* v. *Babler*, *supra* footnote 168 at 934, when the court concluded that the "proper remedy in this case is to enjoin the owners from selling Lot 13 until they receive an acceptable *bona fide* offer for Lot 13 *unrelated to the sale of any other property* [emphasis added]".

[185] *Supra* footnote 3.

[186] Other large transactions in Canada will raise issues of the applicability of rights of first refusal. For example, it is common for contractual arrangements in the oil and gas industry to include rights of first refusal. Consequently, when Amoco and Encor attempt to "rationalize" their holdings by exchanging hundreds of properties without specifically allocating prices, rights of first refusal will be triggered (see J.J. Nieuwenburg and R.P. Desbarats, *The Encor/Amoco/Maligne Asset Rationalization*, Insight Conference on the Acquisition of Oil and Gas Interests, February 25, 1993.) The rights will be triggered because doing numerous transactions contemporaneously in bulk or on a large scale does not alter the fact that the individual subject properties are being sold. The "rationalization sale" agreements executed by the parties to this transaction specifically addressed the issue, each party taking responsibility for liability to holders of rights in purchased properties. The relevant article in one agreement reads as follows:

> After Closing, the Purchaser shall assume liability for, and shall control all matters associated with all consent requirements, rights of first refusal and other preemptive rights relating to the Assets, (collectively "ROFRs"). The Purchaser shall be entitled to forward all requests for waivers or notices related to such ROFRs and may allocate to those Assets associated with any particular ROFR that portion of the purchase price payable hereunder or of the purchase price associated with prior transactions, which the Purchaser reasonably considers appropriate. The Vendors shall cooperate with the Purchaser and forward in the name of the applicable Vendor, to the extent requested by the Purchaser, all such waivers and notices. If a party asserts a ROFR, the Purchaser shall be entitled to make all reasonable responses to such claimants and have control of all proceedings and any actions relating to such assertions, and the Vendors shall cooperate and assist the Purchaser in such matters. If a particular claimant is successful in asserting a ROFR, the Purchaser shall either convey those Assets subject to the ROFR directly to the claimant and retain the proceeds, or make such other settlement with the claimant that the Purchaser deems appropriate.

right of first refusal amounted "to an option to purchase under certain conditions", but that the conditions for its exercise had not been strictly satisfied in this case.[187] The court observed that the vendor "had no document in its hands which met the requirement of the clause [for a "signed offer"]" and that the "language is clear and unambiguous that the right of first refusal applied only to a specific offer with an ascribed price for the [subject property]".[188] This analysis, however, is difficult to support. There was no question of strict compliance here. The holder was never given the opportunity to strictly comply. Rather, this was a question of the reasonable construction of the right of first refusal.[189] The issue was whether the transaction which occurred involved a dealing with the subject property such that it could be said that a sale had taken place. According to the terms of the right of first refusal, it was triggered if "the Lessor receives a *bona fide* offer to purchase the lands and premises herein, which it is willing to accept."[190] This language is typical of that found in the American cases spread over the last fifty years, in almost every one of which the court concluded that the package disposition violated the right of first refusal.[191] Probably the real concern of the *Budget* court, suggested in the judgment, was the absence of an allocated price for the subject property. However, with its compliance circumlocution, the court managed to avoid having to address the pricing issue.

In *Municipal Savings & Loan Corp.* v. *Oswenda Investments Ltd.*, the court took a different approach.[192] Distinguishing *Budget* on its facts, the court found that the sale violated, but did not trigger, the right of first refusal. Kerr J. essentially adopted the approach of those American cases which deny that specific performance is available.[193] The basis for that denial, it will be recalled, is ostensibly that a package sale *per se* does not establish a willingness to sell the subject property separately. Kerr J. accepted this proposition and concluded that, because the right of first refusal was not triggered, no option arose. He went on to find that the vendor had nevertheless violated the right of first refusal, rendering it "nugatory by the device of adding other lands."[194] He then considered ordering the reconveyance of the property to the vendor but, unlike his American predecessors, was "not satisfied that ordering a reconveyance...is, in fact, a real remedy at all."[195] In his view, such a remedy was "illusory and worthless".[196] This outright rejection of the reconveyance remedy makes good sense. It is costly to obtain in terms of both time and money and yet does nothing

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[187] *Supra* footnote 3 at 756.

[188] *Ibid.* at 756.

[189] See *supra* text accompanying footnotes 41-44.

[190] *Supra* footnote 3 at 752.

[191] See *supra* text accompanying footnotes 160-165.

[192] (1989) 7 R.P.R. (2d) 196 (Ont. H.C.).

[193] *Ibid.* at 204.

[194] *Ibid.* at 205-206.

[195] *Ibid.* at 207-208.

[196] *Ibid.* at 208.

more than reestablish the vendor's title.[197] Probably the only effective remedy for a package sale violation is an order for specific performance. However, Kerr J. was not prepared to grant that remedy because he was unable to determine a price. He did not consider whether the right of first refusal itself might imply a price standard.

In *Associated Graphic Supplies Ltd.* v. *B. & L. Properties Development Ltd.*, the court apparently accepted the proposition that the vendor "was under an obligation not to accept an offer for [a package price]" and was in breach "by failing to set out or being in any position to set out a specific price and terms for the sale of [the subject property]".[198] This suggests that the original right of first refusal involved the vendor implicitly agreeing to forego opportunities to dispose of the subject property for synergistic gains attributable to the structuring or packaging of a sale of the subject property.[199] As it was, no claim for specific performance was made by the holder and the analysis went no further. Damages were granted to the holder.

The trial court in *Downtown King West Development Corp.* v. *Massey Ferguson Industries Ltd.*, examined a proposed package sale from which the subject property was withdrawn prior to closing.[200] The court determined that the right of first refusal had been triggered and that the deletion of the subject property from the package did not terminate the option that had been created. On the latter issue, the analysis was limited to referring to a number of authorities that suggested the existence of a duty of good faith on the part of the vendor. The application of this good faith argument was not developed in any specific way. Nor was there a discussion of alternative remedies; the court merely calculating and awarding damages. The Ontario Court of Appeal subsequently reversed the trial court on the distinct ground that no offer capable of acceptance was made.[201] The Court of Appeal found it unnecessary to consider the cases dealing with package sales, including its own decision in *Budget*.[202]

Canadian courts have yet to deal definitively with the package sale. The trend at the trial level, however, is clearly to find a violation of the right of first refusal. This would replicate the established default rule in the American

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[197] For concurring views see Abright, *supra* footnote 6 at 817 and Reasoner, *supra* footnote 182.

[198] (1990), 12 R.P.R. (2d) 254 at 257 (B.C.S.C.).

[199] See *supra* text accompanying footnote 184.

[200] *Supra* footnote 37 (Ont. Gen. Div.).

[201] *Supra* footnote 12. The court stated (at 564) that "[t]his is not a matter of good faith but, rather, a matter of the rights and obligations created by the first refusal agreement".

[202] Subsequently, in a case involving a right of first refusal applicable to a sale of shares (*GATX Corp.* v. *Hawker Siddeley Canada Inc.*, *supra* footnote 4 at 286), Blair J. rejected the package sale argument, concluding that "[w]here the thrust of the offer in question falls clearly within the parameters of a right of first refusal, that right cannot be defeated by the expediency of packaging the transaction in a fashion which makes it appear as if it encompasses something different." Also see *infra* footnote 241.

jurisprudence, and effectively supplant the *Budget* holding. On the remedy side, there is less clarity. Canadian courts have been hesitant to award specific performance as a remedy in the package sale context.[203] There is, however, a valid foundation for ordering specific performance. It would be entirely proper for a court to conclude that a package sale is a triggering event and that the typical grant of a right of first refusal itself implies the willingness of the vendor to dispose of the subject property to the holder at fair market value.[204] Essentially this means only that, as between the original parties, the onus is on the vendor to negotiate *ex ante* any exclusion for package sales. This is the default position which treats both parties reasonably and avoids the greater potential mischiefs. A further benefit is possibly that Canadian courts will not be visited with the same stream of litigation that has characterized the American handling of the issue. It is for us to choose the consequences we prefer.

(n) *Options*

A third party determined to acquire the subject property may be able to obtain from the vendor an option to purchase that is exercisable after the expiration of the right of first refusal. The immediate effect of such an option would be to prevent the sale of the subject property and thus nullify the first refusal.[205] The authorities are divided over whether the vendor and the third party will be permitted to circumvent the right of first refusal in this way. A number of courts in the United States have taken the view that the grant of an option does not trigger a right of first refusal that is activated by a sale or contemplated sale.[206] As well, in *Pritchard* v. *Briggs*, the English Court of Appeal concluded that vendors who had granted a right of first refusal remained free to enter into an option contract whereby they "fettered their powers of disposition so that [they] could not sell in their lifetime to the [rightholder] or to anyone else."[207] However, these decisions are problematic and are opposed by several other American cases.

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[203] Specific performance *was* granted in *GATX Corp.* v. *Hawker Siddeley Canada Inc.*, *supra* footnote 4. Also see *Landymore* v. *Hardy*, *supra* footnote 36; *Law-Woman Management Corporation* v. *Peel*, *supra* footnote 64; *Pushka* v. *Magnowski Estate*, *supra* footnote 110.

[204] See text at footnotes 183-84 *supra*. A *bona fide* express allocation of price by the vendor and third party will often be good evidence of fair market value. However, it is open to the court to find that the allocation was not *bona fide* and then to set the price based on independent valuations.

[205] The third party would proceed with the option device to avoid giving the holder the opportunity to exercise the first refusal. If instead the only concern is to queue up behind the holder, it would be sufficient for the third party to negotiate a second right of first refusal.

[206] *Kings Antiques Corp.* v. *Varsity Properties, Inc.*, *supra* footnote 99; *West End Tenants Association* v. *George Washington University*, 640 A. 2d 718 (D.C. 1994); *Seward* v. *Weeks*, 274 N.E. 2d 813 (Mass. 1971).

[207] [1980] 1 All E.R. 294 at 330 (C.A.).

Courts have reacted to the option fetter in a variety of ways. One response is to find that the first refusal has been triggered. In *Quigley* v. *Capolongo*, the court found that the terms of a combination lease/option effectively amounted to a present sale of the subject property with only transfer of title postponed.[208] Other courts have concluded that an option will trigger a right of first refusal if the activating event is simply an "intention" or "willingness" to sell.[209] In *Rollins* v. *Stokes*, the court stated that the vendor "manifested her intent to sell the property by entering into the option contract."[210] In *Hasty* v. *Health Service Centers, Inc.*, the court was of the view that the grant of the option "demonstrate[d] beyond any doubt the intent of the grantor of the option to dispose of his property".[211] For these courts, the appropriate remedy is to order specific performance of the right of first refusal.

A second judicial reaction is to find that even though the first refusal is not triggered, it is nevertheless violated by the grant of an option. Thus, courts have rejected agreements in which the vendor contracted to not sell the subject property during the term of the right of first refusal. Such agreements simply do directly what options do indirectly and their rejection implies that the indirect form of the fetter is equally unacceptable. In *Wellmore Builders, Inc.* v. *Wannier*, an agreement of this kind was invalidated because the original parties to the right of first refusal "contemplated as part of their bargain that the [vendors] would not destroy their freedom of choice [to sell the property]".[212] Following the *Wellmore* decision, the court in *Guaclides* v. *Kruse* stated that the vendor could not "validly agree that he will not sell the [subject property] to anyone during the life of the option, since to do so would effectively destroy [the holder's] preemptive right prematurely."[213] Then, in the *Rollins* case, which did involve an option rather than a bare agreement not to sell, the court observed that the "use of an option contract with a delayed exercise clause was designed effectively to foreclose [the rightholder] from exercising his preemptive right" and that this would be "inconsistent with the intent and the conduct of the parties."[214]

The distinction between triggering and violating a right of first refusal was explicitly applied in *Hewatt* v. *Leppert*.[215] The court there found that while the grant of the option did not activate the first refusal, it did violate that right. The breach occurred when the grant of the option "diminished the value" of the first

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[208] 383 N.Y.S 2d 935 (App. Div. 1976).

[209] These cases illustrate once again the importance of the language used to frame a right of first refusal. Apart from that, this particular approach is potentially capable of covering many of the standard provisions in current use.

[210] 176 Cal. Rptr. 835 at 840 (Ct. App. 1981).

[211] 373 S.E. 2d 356 at 358 (Ga. 1988).

[212] 140 A. 2d 422 at 428 (N.J. Super. A.D).

[213] *Supra* footnote 168 at 495.

[214] *Supra* footnote 210 at 842.

[215] 376 S.E. 2d 883 (Ga. 1989). Also see *In Re Club Associates*, *supra* footnote 4 at 1233-34.

refusal. The court observed that the "essence of the [holder's] right of first refusal was the *possibility* of matching a third party's acceptable offer"[original emphasis].[216] The vendor "destroyed this possibility when he executed the option contract...and thus diminished the value of the [holder's] right of first refusal."[217]

This state of the default jurisprudence probably favours the third party.[218] If determined to acquire the subject property, the third party could take the option and hope that the court will find either that the right is not thereby triggered or, alternatively, that it is merely violated. In the latter case, the third party's acquisition objective will ultimately be achieved, albeit at the uncertain cost of paying damages in the amount by which the value of the right is diminished. The court may instead determine that the grant of the option triggered the right of first refusal and order specific performance for the holder. However, if the holder insists on taking and keeping the subject property, the third party would not likely have acquired it in any event and is no worse off for having attempted the circumvention. Accordingly, the effect of the current American default position is to place on the rightholder the onus of expressly addressing whether the grant of an option is to trigger the right of first refusal. This would likely also be the case in Canada given the holding in the *Pritchard* case.[219]

(o) *Rights to Use the Subject Property*

A vendor might restrict the ability of the holder to enjoy the original value of the subject property by subsequently granting rights to third parties to use the property.[220] It has been held, for example, that the grant of an easement does not trigger a right of first refusal.[221] Similarly, unless it is a mineral lease, a lease of the subject property will not activate a first refusal.[222] These, however, are contestable propositions. In the case of an easement, it is not at all clear why the vendor should be entitled *ex post* to diminish the subject property by burdening it with a servitude.[223] Moreover, with respect to both easements and leases, the magnitude of the restriction imposed on the holder should matter. Thus, an

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[216] *Ibid.* at 885.

[217] *Ibid.*

[218] Subject to the observation in footnote 209, *supra.*

[219] *Supra* footnote 207.

[220] The vendor might also restrict the use of the subject property by accepting restrictive covenants.

[221] *Wellmore Builders, Inc.* v. *Wannier*, *supra* footnote 212.

[222] An oil and gas lease is a "sale" of an interest in land. See *Sanchez* v. *Dickinson*, 551 S.W. 2d 481 (Tex. App. 1977); *Cherokee Water Company* v. *Forderhause*, 641 S.W. 2d 522 (Tex.1982); *Barela* v. *Locer*, 708 P. 2d 307 (N.M. 1985).

[223] The court in *Wellmore*, *supra* footnote 212 at 427, did not decide whether the easement would be cut off by the exercise of the first refusal.

easement for a laneway through the middle of a residential lot, or a lease for 100 years, may amount to a disposition of close to the entire value of the subject property and arguably should trigger the first refusal. At this point, however, the analysis in the cases remains undeveloped. Consequently, the onus is again on the holder of the right to expressly address these possibilities.

(p) *Involuntary Transactions*

The American jurisprudence remains unsettled on the question of whether an involuntary transaction will trigger a right of first refusal.[224] One court, after reviewing the earlier decisions, concluded that the answer in a given case will depend entirely on the language of the particular first refusal.[225] However, whether this is a satisfactory explanation or justification of the conflicting results in all the cases may perhaps be doubted. A first observation is that the literal or grammatical construction approach does not necessarily resolve the issue in an uncontroversial way. The terminology of the typical provision identifies the triggering event as a willingness to sell. This might initially appear to suggest that an involuntary sale does not activate the right. However, some "involuntary" sales are the consequence of the vendor's voluntary act of *risking the sale* of the subject property. An obvious example is where the vendor charges or mortgages the subject property. The subsequent foreclosure is involuntary, but it only occurred because of a prior voluntary decision to expose the subject property to such a sale.[226] Each party has a plausible argument here. The "willingness to sell" terminology appears able to accommodate either view; the language used is not sufficiently developed to differentiate between the two possibilities. This is the kind of circumstance where a pre-established external default rule is particularly useful. If the general presumption is defined *ex ante* to be, for example, that every sale or proposed sale, whether voluntary or not, triggers the standard first refusal, the onus is placed squarely on the vendor to expressly exempt any particular type of involuntary transaction. This will not completely eradicate the need to deal with textual ambiguity,[227] but it will identify for the parties which of them is assuming the risk of not addressing whether the right of first refusal applies to an involuntary transaction.

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[224] See Abright, *supra* footnote 6 at 813-15 and the annotation at 17 A.L.R. (3d) 962.

[225] *Henderson* v. *Millis*, 373 N.W. 2d 497 at 503 (Iowa 1985). This language dependency is glossed over in the reference to the Henderson case in *Colby* v. *Colby*, *supra* footnote 33.

[226] See *Hornsby* v. *Holt*, 359 S.E. 2d 646 at 649 (Ga. 1987) (the vendor "put the wheel in motion for the sale").

[227] Even direct language may be challenged. See, for example, *Citizens Bank & Trust Company of Maryland* v. *Barlow Corporation*, 456 A. 2d 1283 (Md. 1983); *Seattle-First National Bank* v. *Westlake Park Associates*, 711 P. 2d 361 (Wash. App. 1986).

A second observation is that, while some decisions appear to rest on a purely grammatical foundation,[228] other decisions have been made with a view to the acknowledged functions of rights of first refusal. In *Price* v. *Town of Ruston*, for example, the court determined that the foreclosure sale triggered the first refusal because "one of the main purposes of the option was to save [the holder] from the danger, in case of a forced sale, of having to bid an exorbitant price to prevent any one else" from occupying the subject property.[229] Then, in *Cities Service Oil Company* v. *Estes*, the court stated that "[s]ince a right of first refusal is inserted in a lease for the benefit of the lessee, we must interpret it with that purpose in mind."[230] The right of first refusal was there found to have been triggered by a judicial sale because the right was intended "to protect the expenditures made in the premises by the lessee and the good will the gas station operation had established at the location".[231] Accordingly, once the intended function is recognized as a relevant factor in the analysis, the construction of a particular right of first refusal becomes something more than a mere grammatical inquiry.

In any event, the results of the cases do diverge. Thus, while charging the subject property to secure a loan is not a triggering event,[232] the sale upon a subsequent foreclosure may or may not activate the right. In *Price* v. *Town of Rustony*,[233] the foreclosure sale triggered the first refusal, but in *Draper* v. *Gochman*[234] it did not. Conflicting results are also found in the cases dealing with sales by representatives of deceased vendors.[235] A few additional American cases deal briefly with various other types of involuntary transactions.[236] In the only Canadian case, *McCarter* v. *York County Loan Company*, the court determined that a judicially-approved sale by the liquidator of an insolvent corporation did trigger the right of first refusal.[237] Accordingly, with these conflicting results, neither party can rely on the default position. As a practical matter, as between the parties, the effect of the conflict is to locate with the

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[228] See *Draper* v. *Gochman*, 400 S.W. 2d 545 (Tex. 1966); *Henderson* v. *Millis*, *supra* footnote 225.

[229] 132 So. 653 at 656 (La. 1931).

[230] 155 S.E. 2d 59 at 63 (Va. 1967).

[231] *Ibid.*

[232] *Draper* v. *Gochman*, *supra* footnote 228 at 547 ("[t]o so hold would virtually prevent the mortgaging of property on which there was a right of first refusal"); In *Re Club Associates*, *supra* footnote 4 at 1229-33.

[233] *Supra* footnote 229. Also see *Hornsby* v. *Holt*, *supra* footnote 226.

[234] *Supra* footnote 228. Also see *Henderson* v. *Millis*, *supra* footnote 225.

[235] See *Cities Service Oil Company* v. *Estes*, *supra* footnote 230; *Loftin* v. *Estate of Loftin*, 746 P. 2d 130 (Nev. 1987); *Richfield Oil Corporation* v. *Security-First National Bank of Los Angeles*, 323 P. 2d 834 (Cal. App. 1958); *In Re Rigby's Estate*, 167 P. 2d 964 (Wyo. 1946).

[236] *Blankman* v. *Great Western Food Distributors, Inc.*, 293 N.Y.S 2d 368 (Sup. Ct. 1968); *Kowalsky* v. *Familia*, 336 N.Y.S. 2d 37 (Sup. Ct. 1972). Also see *Pearson* v. *Schubach*, 763 P. 2d 834 (Wash. App. 1988) (holder estopped from asserting first refusal).

[237] *Supra* footnote 102.

holder of the first refusal the burden of expressly addressing the prospect of an involuntary sale.

(q) *Circumvention Devices*

The array of default rules outlined above allows some scope for a vendor and third party to circumvent a right of first refusal. Reference has been made to a number of the possible arrangements. Other modes of circumvention could employ the various rules instrumentally. Thus, where the vendor is a corporation, it might dissolve and distribute the subject property *in specie* to a third party who has acquired shares.[238] Or a vendor may mortgage the subject property and then intentionally default.[239] Another possibility might be a step transaction, where a series of steps are adopted by the vendor and third party purchaser to replace (and disguise) a simple asset sale.[240] One attempt to do this, involving a sale of shares, is found in the recent Ontario case of *GATX Corp.* v. *Hawker Siddeley Canada Inc.*[241] Generally speaking, however, these kinds of strategies are often too crude, complex, obvious or impractical to be used once the right of first refusal has been granted. The devices will likely be more effective when their potential deployment is arranged in advance of the grant. For example, the dissolution tactic will be that much more workable if the subject property is originally placed in a corporation without other (or other valuable) assets.

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[238] See *supra* text accompanying footnotes 99-105.

[239] See Cooney & Ausherman, *supra* footnote 6 at 17-18 and the case extracts, *infra* footnote 242.

[240] A hypothetical step transaction was considered in *Prince* v. *Elm Investment Co., Inc.*, *supra* footnote 52. According to the court at 823 (footnote 3), "[a]lthough a transfer of corporate stock to a stranger to the lease may not be a `sale', and a transfer from a corporation to its stockholders (or vice versa) may not be a `sale', there would probably be a sale if these two steps occurred in sequence according to a pre-arranged plan." However, in *LaRose Market, Inc.* v. *Sylvan Center, Inc.*, *supra* footnote 106, the court referred to the Prince hypothetical and concluded that the transactions *would* be permissible in the absence of bad faith. Whatever may be the view of the American courts, it was earlier suggested (*supra* text accompanying footnotes 142-45) that in Canada the second step in the hypothetical would trigger the right of first refusal.

[241] *Supra* footnote 4. The case involved a proposed step transaction which sought to recast an asset (shares) sale as a transfer of corporate ownership. The corporate shareholder (the vendor) was to first transfer the subject property (the shares) to a wholly-owned subsidiary. This would not trigger the right of first refusal because transfers to affiliates were contractually exempted from its operation. The corporation would then dividend out to its own shareholders all of the shares of the subsidiary. The third party purchaser would thereafter make a takeover bid for all of the shares of the subsidiary.

The court was of the view that this proposed series of transactions, arranged by agreement between the vendor and third party purchaser, must be judged as a whole. In the result, although each transaction was ostensibly unobjectionable in isolation from the others, the overall plan effected a disposition which triggered the right of first refusal. The court also found that the proposed transactions breached the duty of good faith owed by the vendor and, further, amounted to "oppression". The remedy was an order for specific performance.

Courts, of course, do recognize that these sorts of *ex ante* and *ex post* structurings will occur in practice. However, judges are reluctant to accept allegations of bad faith or fraud without clear evidence.[242] It is therefore largely up to the holder to do what is possible to counter the various circumvention devices.[243]

Perhaps the greater practical concern for the holder of the right is the prospect of the vendor fabricating an offer to elevate the price of the subject property. A circumvention of the first refusal occurs here in the sense that the price offered is not the price an independent third party is prepared to pay. This mischief is ostensibly regulated by the usual requirement in a right of first refusal that the third party offer must be *bona fide*. A sham offer may alternatively be used, not to extract a higher price from the holder, but to avoid the right of first refusal altogether. A particularly inept attempt at fabricating such an offer was considered in *Landymore* v. *Hardy*.[244] The vendors in that case had incorporated a corporation which they then caused to make an extravagant offer for the subject project. They eventually admitted that they were behind the corporation, but they claimed they had only a tax motive for wishing to transfer the subject property to the corporation. The court found instead that one of their main motives was "to avoid or nullify" the right of first refusal.[245] It will not often be the case, however, that this sort of artificial pricing can be detected. The prudent holder may therefore contemplate negotiating *ex ante* for the right to elect to take the subject property at the offered price or its fair market value, whichever is less, should the vendor be willing to sell.[246]

(r) *Contractual Exclusions*

The contracting parties are initially free to exclude any particular transaction from the reach of a right of first refusal. Often there are no express exclusions. In the oil and gas industry, on the other hand, it has in the past been quite

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[242] *Draper* v. *Gochman*, *supra* footnote 228 at 547 ("There is no evidence here that the loan transaction with its attendant mortgage or deed of trust was intended as a subterfuge or device to sell the property so as to defeat Gochman's first right of refusal in the event Baxter desired to sell"); *Henderson* v. *Millis*, *supra* footnote 225 at 502 ("No evidence appears that the foreclosure sale was `rigged' to evade the first instrument"); *Raymond* v. *Steen*, 882 P. 2d 852 (Wyo. 1994); *Quigley* v. *Capolongo*, *supra* footnote 208.

[243] For example, the holder should specify that any transfer, including an involuntary conveyance or transfer "by operation of law", is an event that will trigger the right of first refusal. The holder might also insist that a change in control of the vendor (e.g. sale of shares) should activate the first refusal.

[244] *Supra* footnote 36.

[245] *Ibid.* at 198.

[246] The purpose of such a provision would be simply to guard against loss of the right through price setting. It is always open to the holder to pay an amount in excess of the fair market value to encourage the vendor to sell.

common for a particular set of events to be excluded.[247] These events became standard industry exclusions after they were included in the first refusal clause in the original 1956 American Association of Petroleum Landmen Form 610, Model Form Operating Agreement.[248] After providing for the right of first refusal, the clause stated that "*there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.*"[249] This clause remains essentially unchanged in the current version of Form 610.[250] In Canada, the corresponding clause in the Canadian Association of Petroleum Landmen 1981 Operating Procedure is marginally more elaborate, but ostensibly less problematic.[251] The difficulty with the American clause, still found in Canadian contracts, is the terminology used. Specifically, the terms merger, consolidation and reorganization are unclear. To the extent they are unclear, there is uncertainty with respect to the scope of application of the first refusal right. It is therefore necessary to ascertain

[247] See Kutzschbach, *supra* footnote 6 at 18-19; Sellingsloh, *supra* footnote 6 at 39-40. For an example of an exclusion clause outside the oil and gas context, see *GATX Corp.* v. *Hawker Siddeley Canada Inc.*, *supra* footnote 4 at 261. The clause was utilized as part of a step transaction intended to avoid triggering a right of first refusal. See *supra* footnote 241.

[248] See *Keefe*, *supra* footnote 6 at 2.

[249] *West's Legal Forms*, 2nd ed., Vol. 28, 1995 Supp., para. 23.161A, art. 8(f).

[250] The 1989 version states that "there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock."

[251] Clause 2401, providing the right of first refusal, is qualified by clause 2402 as follows:

> Exceptions to Clause 2401 — Clause 2401 shall not apply in the following instances, namely:
>
> (a) An assignment made by way of security for the assignor's indebtedness.
>
> (b) An assignment, sale or disposition to an affiliate of the assignor, or in consequence of a merger or amalgamation of the assignor with another company or pursuant to an assignment, sale or disposition made by a party of its entire participating interest in the joint lands to a corporation in return for shares in that corporation or to a registered partnership in return for an interest in that partnership.
>
> (c) An assignment, sale or disposition made by the assignor of all, or substantially all, or of an undivided interest in all or substantially all, of its petroleum and natural gas rights in the province, state or territory where the joint lands are situated.
>
> (d) An assignment, sale or disposition by a party in which the net acres being assigned, sold or otherwise disposed of by that party in the joint lands represents less than five (5%) percent of the total net acres being assigned, sold or otherwise disposed of by that party pursuant to the transaction affecting its interest in the joint lands.

the default interpretation of those terms before the ambit of the right of first refusal can be fully comprehended.

In the United States, "merger" and "consolidation" are related but technically distinct notions. A statutory merger involves "a combination whereby one of the constituent companies remains in being — absorbing or merging in itself all the other constituent corporations".[252] A consolidation, on the other hand, occurs "when two combining corporations are dissolved and lose their identity in a new corporate entity".[253] Accordingly, the technical distinction is that "there can never be a consolidation of corporations except where all the constituent companies cease to exist as separate corporations and a new corporation, the consolidated corporation, comes into being".[254] This conceptual bifurcation of corporate combination is not found in Canada. Canadian statutes instead substitute the singular notion of "amalgamation" for both merger and consolidation.[255] Thus, where governed by Canadian law, the merger and consolidation exceptions arguably may be read collectively as a reference to a statutory amalgamation.[256]

The term reorganization has a technical meaning in the United States. It is the name applied to proceedings under Chapter 11 of the *Bankruptcy Code*. In Canada, the term has both a specific statutory meaning and a general commercial meaning. Under s. 191 of the *CBCA*, a reorganization is defined to be a court order made pursuant to certain statutory schemes.[257] More generally, the term

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[252] (1986) 19 Am. Jur. (2d), para. 2510 at 325-26.

[253] *Ibid.* para. 2509 at 325.

[254] *Ibid.*

[255] Eg. *CBCA*, ss. 181-186.

[256] See 19 Corpus Juris Secundum, para. 792 ("*Amalgamation* is a term employed in England apparently in the same sense that *consolidation* is used in this country, and is used by the English courts, as consolidation is used by the American courts, to designate a merger as well as what is properly designated as a consolidation").

[257] The original Dickerson Committee explanation for sec. 191 (Dickerson, *et al.*, *Proposals for a New Business Corporations Law for Canada*, vol. 1, (Ottawa: Information Canada, 1971) at 124 (para. 374) reads as follows:

> To clear up the obscure meaning of "reorganization", subsection (1) of s. 14.18 states that the term includes a court order made under the Bankruptcy Act, s. 19.04 and any other federal law. The object of the section is to enable the court to effect any necessary amendment of the articles of the corporation in order to achieve the objective of the reorganization without having to comply with all the formalities of the Draft Act, particularly shareholder approval of the proposed amendment. For example, the reorganization of an insolvent corporation may require the following steps: first, reduction or even elimination of the interest of the common shareholders, second, relegation of the preferred shareholders to the status of common shareholders; and third, relegation of the secured debenture holders to the status of either unsecured note holders or preferred shareholders. Presumably then the corporation will be in a position to borrow further upon the security of its assets. In addition, the court will have power to reconstitute the board of directors, thus permitting representatives of the creditors of the corporation to take over the administration of the corporation until the corporation is once again solvent.

tends to be used to describe a restructuring or re-capitalization brought about by reason of financial distress. Reorganization is "the procedure whereby a debtor in failing circumstances can be made economically sound and at the same time the legal rights, in so far as they exist, of the creditors and shareholders can be preserved or modified under some sort of arrangement fair to all, which usually involves some scaling down of the creditors' claims".[258] A reorganization is also understood to involve an adjustment of the interests of the stakeholders in a single corporation. In *Kennedy v. Minister of National Revenue*, Cattanach J. stated that if an undertaking is not to be wound up "but should be continued in an altered form in such manner that substantially the same persons will continue to carry on the undertaking, that is what I understand to be a reorganization."[259] In his view, "[i]t is that the same business is carried on by the same persons but in a different form".[260]

Thus, the "reorganization" exception would appear to have a limited ambit, if, indeed, it has any relevance at all in Canada. Presumably its inclusion in the American clause was intended to exempt transactions authorized in a "reorganization" proceeding under Chapter 11. It is not sufficiently specific to have the corresponding effect in Canada. Arguably, in the Canadian context, it is simply too vague. Nevertheless, Canadian courts may strive to give the term meaning. This will likely be problematic for the holder of the right of first refusal. Many transactions may conceivably be justified if they are somehow remotely connected with a financial or other "reorganization" of the vendor. Probably the holder should resist the reorganization exception unless its meaning is satisfactorily defined in the documentation of the right.

Conclusion

The Anglo-Canadian jurisprudence on rights of first refusal is incomplete. Significant issues have yet to be considered by any court. In other respects, only limited development has occurred. The default framework is skeletal and, in places, frail. It is possible to augment this framework with the additional bulk of the American cases. Unfortunately, however, that incorporates a further measure of uncertainty. The uncertainty arises both from the conflicts within the American case law and the seemingly more hostile approach of American judges to rights of first refusal in general. Both the Anglo-Canadian and American default positions leave room for opportunistic arrangements on the part of a vendor and third party seeking to avoid a right of first refusal (eg. unique consideration, options, package sales, usage rights). However, there are additional circumvention possibilities in the United States (eg., gifts, changes of form). The difference appears to flow from distinct conceptualizations of the activating

[258] J.D. Hornsberger, *Debt Restructuring: Principles and Practice*, Vol. 1 (Toronto: Canada Law Book, 1995) (loose-leaf) at para. 1:02.

[259] [1972] C.T.C. 429, at 436-37 (F.C.T.D.).

[260] *Ibid.*

event. Some American courts picture the triggering event as an *arm's length* sale. They are therefore reluctant to apply the right of first refusal where the subject property is gifted to another, transferred to co-owners or moved to a different structure or form without any substantial change in beneficial ownership. Anglo-Canadian courts, on the other hand, have not read in the *arm's length* element. At least to this point, they appear to regard any disposition of the subject property as intended to attract the application of the right of first refusal.[261] This, arguably, is the preferable default position. It more plausibly reflects the assumptions of the holder and vendor at the time of their original transaction. Without more, there is no evident basis for implying into their arrangement an exclusion for transactions that are not at arm's length. Given the potential for bad faith or manipulation, the burden of exempting transfers to volunteers or related parties should properly be placed on the vendor. This, however, is not to suggest the blanket rejection of the American default jurisprudence. The American experience has generated a body of material that explores many of the relevant considerations. We may use it to inform, if not determine, our own choices.

The Anglo-Canadian default regime is currently more favourable to holders than is the American regime. However, this is only a relative advantage. In both instances, in absolute terms, the holder of the right is still in a vulnerable default position. The burden is therefore largely on the prospective holder to negotiate an effective right of first refusal. From the point of view of the holder, the typical clauses now in use are inadequate.[262] Matters ranging from assignability to involuntary sales need to be addressed. The task is to clearly identify those circumstances where the right of first refusal is to apply. The cases establish that the exact wording of the clause will be critically important. A prudent holder should probably avoid conceptualizing the triggering event as a sale or willingness to sell. Instead, the holder should begin by bargaining for a first refusal that is activated by *any change of control of the vendor or by any disposition, transfer, alienation or exchange of any part of the subject property or interest in the subject property, whether voluntary or involuntary, or by operation of law, including by way of gift, combination (merger, amalgamation), dissolution, lease, option, easement or any other arrangement or transaction by which a beneficial interest or usage is acquired by any person, organization or entity, whether or not related, affiliated or connected to the vendor, directly or indirectly.* It is then for the vendor to identify for the holder those circumstances in which the holder is not to be given the opportunity to acquire the subject property.

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[261] The jurisprudence is thin, and, consequently, the proposition is based primarily on the treatment of gifts and the absence of any discussion in the cases of an arm's length requirement. Also see the court's interpretation of the right of first refusal in the shareholder's agreement in *GATX Corp.* v. *Hawker Siddeley Canada Inc.*, *supra* footnote 4. Blair J. concluded (at 276) that "the parties intended to encompass all means and methods by which either of them might choose to terminate their interest in the [subject property]".

[262] A variety of draft clauses have been developed by commentators to offer some guidance. See Abright, *supra* footnote 6 at 822-24; Borgerson & Dolan, *supra* footnote 6 at 57-68; Cooney & Ausherman, *supra* footnote 6 at 28-33.