

## CREC-approved contracts: Rights of first refusal & contract approval

This is the 14th in a series of 17 or so articles that come from some years of experience using the Colorado Real Estate Commission-approved contracts for purchase and sale of real estate for commercial real estate transactions. Previous articles addressed the buyer's name, the seller, the property, water rights, ordering the title commitment, owner's extended coverage, making title objections, off-record matters, special taxing districts, ordering and reviewing the new improvement location certificate survey and owners' associations. This article addresses rights of first refusal and contract approval.

Section 8.6 addresses a circumstance that occurs commonly in the sale of older condominium units, but only occasionally otherwise, the existence of a ROFR. A ROFR grants to the holder (in a condominium it may be the other owners or the association) the right to match a third-party offer. When an owner wants to sell the property to a third party, the owner first gives the holder or holders notice of the offer. The holders of the ROFR have a specified time within which to accept the offer or not. Section 8.6 applies if the contract is such a third-party offer and, of course, if the holder of the ROFR accepts the terms of the contract, the contract terminates as to the third-party buyer. Section 8.6 also addresses a circumstance that occurs even less commonly, the existence of a right to approve the contract after it is signed. **Trap:** *The contract does not specify who might have the right to approve the contract, so an "easy out" for the seller might occur based on an internal, rather than a third-party, approval.* For example, the seller might terminate the contract based upon the



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approval of a senior officer or board of directors of the seller.

The contract begs an important question. Did the buyer know that the property was subject to a ROFR or an approval right?

Conventional wisdom is that a ROFR or an approval right scares buyers away. **Tip:** *A buyer is wise to add to the contract a representation and warranty of the seller that the property is not the subject of any third-party rights of this kind.* If the buyer has no patience for such nonsense, he or she can look elsewhere and not suffer the difficulties of §8.6 or the prospect of losing the deal.

If a ROFR or approval right exists, the seller "must promptly submit the contract according to the terms of such right." If the ROFR is exercised or the contract is disapproved, the contract terminates. The contract states, "seller must promptly notify buyer in writing of the foregoing." **Trap:** *The seller is not obligated to provide any written evidence of the exercise of the ROFR or the disapproval of the contract.* Implicit in this procedure is trust in the seller not only to report the response accurately but to do so promptly.

The contract remains in full force and effect if the ROFR is "waived explicitly or expires." **Trap:** *It is not clear that "explicitly" means that the waiver needs to be in writing from the holder of the ROFR.* It would be better for the buyer to require such a

writing. **Trap:** *The contract does not deal with the circumstance where a right of first refusal or contract approval right is, by its terms, deemed to be waived.* Any number of things may keep the holder of the ROFR from exercising the right. **Trap:** *Who makes the determination whether or not the ROFR has expired?* Sometimes the expiration of a ROFR is disputed because it is not clear whether the notice given by the seller is adequate and properly given or whether or not time is of the essence in the exercise of the ROFR. The contract also remains in force if the "contract is approved." **Trap:** *The contract does not state how contract approval is to be evidenced.* Again, the contract simply requires the seller to promptly notify the buyer in writing of the foregoing, and the same concern exists as to notice coming only from the seller. **Tip:** *The buyer should add a clause that the seller must satisfy the title insurance company that the ROFR and any contract approval right no longer affects title to the property.* Not only should the buyer be protected from a third party claiming a right to buy the property to object to the sale to the buyer, but also the buyer's lender is almost certainly going to require that protection.

**Trap:** *Under §8.6, the contract could terminate without the buyer knowing it when it happens.* The contract terminates or continues based on what happens with the right of first refusal or contract approval and not based on notices from the seller as to what has happened. The seller is merely obligated to "promptly" notify the buyer of the outcome. The buyer could be spending money on due diligence unaware that the contract has terminated.

Title insurance protection against a ROFR or a contract approval right can come in a number of forms. The title company might delete the agreement in which the ROFR or contract approval right exists from the exceptions to title. Often, however, the rights are contained in an agreement that needs to remain an exception for other reasons. In appropriate circumstances, the title insurance company will issue an ALTA Endorsement 9.9 06 (Private Rights Owner's Policy) Endorsement to the owner and an ALTA Endorsement 9.6 06 or ALTA 9.6.1 06 (Private Rights Loan Policy) to the lender. If the property is a condominium, the title insurance company might issue an ALTA Endorsement 4.1 06 (Condominium) to the owner and an ALTA Endorsement 4 06 or ALTA 4.1 06 (Condominium - Loan Policy) to the lender. If the property is in a planned unit development, an ALTA Endorsement 5.1-06 (Planned Unit Development) is available to the owner and a lender and an ALTA Endorsement 5-06 (Planned Unit Development Loan Policy) is available to a lender. All of these endorsements are available only if the underwriting requirements are met, which, among other things, will require the buyer to convince the title insurance company that the ROFR or contract approval right is not going to impair the buyer's title. **Tip:** *Since a ROFR or a contract approval right is, in the first instance, the seller's problem, the buyer will want title insurance over those rights to be a condition to closing, and will want the seller to cooperate in getting that coverage and to pay for any endorsements.▲*