

Rights of first refusal - are they single use?

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A right of first refusal (“ROFR”) is a right that is granted to a party which typically provides the grantee the right to match a third-party offer from an arm’s-length party for the acquisition of real or personal property, such as an interest in land or shares in company. In the real property context, a high-value tenant or neighbouring landowner may be able to negotiate a ROFR for the purchase of an adjoining property or a property they lease. In the corporate context, shareholders in a corporation may grant reciprocal ROFR rights in a shareholders’ agreement. In both cases, the general principle is the same. If the grantor of the ROFR receives a bona fide offer from an arm’s-length third party, there arises an obligation to notify the ROFR holder of the offer and provide them with the opportunity to match the third-party offer within a specified time frame.

In the case of *McMullen v Dilawri Property Holdings Ltd.*,¹ the Ontario Superior Court confirmed that after a ROFR is exercised, the common law rule prevails and the ROFR is spent after its first use, where proper language to the contrary is not provided.² This case serves as a cautionary tale for both real estate and business lawyers in drafting ROFRs. Careful consideration as to the terms under which these rights may be extinguished or revived is required.

ROFRs in Context of the Sale of a Corporation

ROFRs appear often in the context of shareholders’ agreements. Minority or other equally participating shareholders may hold the right to match those third-party offers. This typically takes two forms: (1) an ‘all or nothing’ approach where the ROFR holder must buy all of the shares of the selling shareholder or none at all; (2) the ROFR holder has an option to purchase a particular amount or proportion of the shares being sold, or a ‘stub’ portion of shares. From the perspective of a third-party arm’s-length buyer who is looking to acquire a majority stake in a corporation, a ROFR that provides for the purchase of a stub portion of the shares may be even more unattractive than an all or nothing ROFR, given that it does not allow for them to complete the deal on their desired terms, through no fault of their own.

Where a shareholder is looking to sell their shares and exit a corporation, the presence of a ROFR may act as a hindrance in the completion of the sale, as many third-party buyers do not wish to proceed with a due diligence process and putting together an offer, to only lose the opportunity to purchase to an existing shareholder, who only needs to match the terms of their

¹ *McMullen v Dilawri Property Holdings Ltd*, 2023 ONSC 599 [hereinafter *McMullen*].

² *Ibid* at para. 22.

offer.³ The consequence of the presence of a ROFR can often mean that the asset, whether it is shares in a corporation or real estate, is less liquid than where no ROFR is present.⁴

ROFRs and the *Land Titles Act*

Similar to the sale of shares in a corporation, the presence of a ROFR for a property can hinder its saleability and make the property less attractive to potential purchasers. While in the corporate context the shareholders' agreement is a likely place to look for ROFRs in due diligence, in real estate, ROFRs can be registered directly on title to the property with the Land Registry Office.

Unlike an option to purchase or a right to repurchase, a ROFR does not immediately create an interest in land.⁵ Instead, a ROFR is first a contractual agreement that has the potential to later create an interest in land.⁶ The Ontario Court of Appeal, in *Benzie v. Hania*, considered what constituted valid consideration for a ROFR as well as whether a ROFR qualified as a registrable interest under section 71 of the *Land Titles Act*.⁷ The Court of Appeal found that a ROFR's potential to become a future interest in land was enough to allow for its registration on title, despite the interest in land not being crystallized until the ROFR converts into the option to purchase, which occurs after the terms of the exercising of ROFR have been met.⁸ Prior to the Court of Appeal opining on the registration of ROFR rights on title, the Director of Titles specifically allowed for the registration of an ROFR through the registration of a Notice pursuant to section 71 of the *Land Titles Act* (Ontario), as an "unregistered estate, right, interest or equity in land".⁹ Further instructions on the registration of a Notice of Right of First Refusal can be found in Bulletin 96001 and the Electronic Registration Procedures Guide.¹⁰

The deletion of a registered ROFR right is done by way of an Application General.¹¹ In order to delete the ROFR from title, the right must first be expired. In *McMullen*, the court considered whether the ROFR was expired and therefore, if application to delete the ROFR could be granted.

³ Donald West, *Business Acquisition Agreements: An Annotated Guide*, 2nd ed (Canada Law Book, 2011) at 163.

⁴ *Ibid* at 164.

⁵ Paul M Perell, "Options, Rights of Repurchase and Rights of First Refusal as Contracts and as Interests in Land" (1991) 70-1 Canadian Bar Review 1, 1991 CanLIIDocs 197, <<https://canlii.ca/t/skp5>>, retrieved on 2023-11-22.

⁶ *Ibid*.

⁷ *Benzie v Hania*, 2012 ONCA 766 (CanLII), <<https://canlii.ca/t/ftq88>>, retrieved on 2023-11-22; *Land Titles Act*, RSO 1990, c L5, s 71.

⁸ *Ibid* at para 67.

⁹ Ontario, Ministry of Government and Consumer Services, *Electronic Registration Procedures Guide* (v 12, December 2017) at 109 online: <https://www.teraview.ca/wp-content/uploads/2018/02/ERPG-V12-2017-Final-English-AODA-.pdf>.

¹⁰ Ontario, Ministry of Consumer and Commercial Relations: Registrations Division Real Property Branch, *Notice of under Section 71*, Bulletin 96001 (10 July 1996) online: https://files.ontario.ca/notices_under_section_71_land_titles_act_-_1996.pdf; *Ibid*.

¹¹ Ontario, *supra* note 9 at 105.

McMullen v Dilawri Property Holdings Ltd.

Prior to hearing of the application, the Ontario Superior Court heard a motion for the production of the Agreement of Purchase and Sale in December of 2022, which was denied.¹² The application was then heard on the 20th of January 2023.

Ms. McMullen, the applicant and property holder, was seeking an order to delete the ROFR from title to the property that was in favour of the respondent Dilawri Property Holdings Ltd. Ms. McMullen granted the ROFR as part of a transaction where three parcels of land were sold to Dilawri and Ms. McMullen retained a fourth adjacent parcel. Ms. McMullen entered into an agreement of purchase and sale with Glenview Properties for the property subject to the ROFR. Dilawri provided notice to Ms. McMullen within the requisite 5-day notice period, in accordance with the ROFR, to exercise its right and purchase the parcel of land.¹³

Ms. McMullen and Dilawri then entered into a conditional agreement of purchase and sale, with Dilawri having a period to complete its due diligence to satisfy itself as to the feasibility to develop the property.¹⁴ Dilawri failed to satisfy itself within the required timeframe and sought an extension from Ms. McMullen for the conditional period, which she declined, thus terminating the transaction. Ms. McMullen then entered into an agreement of purchase and sale for the property the next day with a third party. This new agreement was not served on Dilawri, who argued that following the termination of its agreement with Ms. McMullen, the ROFR continued, and it should have been provided with notice of the new offer, as per the terms of the original ROFR. Ms. McMullen took the position that the ROFR was terminated when it was originally exercised by Dilawri pursuant to the first agreement.¹⁵

In the decision, the court confirmed the status of the common law, as set out in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*,¹⁶ whereby, if there is a bona fide third-party purchase and proper notice is provided to the ROFR holder, a ROFR is extinguished if the ROFR holder:

1. exercises their right to purchase but “later declines to purchase the property”;¹⁷ or
2. does not exercise their right to purchase.

The agreement between the parties, however, included wording that if the transaction contemplated by the arm’s-length offer was “...not be completed for any reason, this Right of First Refusal shall be reinstated.”¹⁸ As the court states, the main issue is whether the ROFR is

¹² *McMullen v Dilawri Property Holdings Ltd*, 2022 ONSC 7182.

¹³ *McMullen*, *supra* note 1 at para 3.

¹⁴ *Ibid* at para 4.

¹⁵ *Ibid* at para 5.

¹⁶ *Canada Deposit Insurance Corp v Canadian Commercial Bank* (1992), [1992 CanLII 6109 \(AB KB\)](#), 89 DLR (4th)168 (Alta QB).

¹⁷ *McMullen*, *supra* note 1 at para 9.

¹⁸ *Ibid* at para 14.

reinstated when the ROFR notice is properly delivered and the buyer does provide a notice of intention to purchase the property.¹⁹

Ultimately the court sided with Ms. McMullen in holding that where the ROFR contractual right is silent, the common law prevails. In this case, the ROFR right did not specify that the right would be revived in a circumstance where notice has been properly delivered, the intention to purchase has been exercised, but the transaction failed to be completed by the purchaser. As this circumstance was not expressly addressed, the ROFR right was extinguished pursuant to existing common law principles.²⁰

Conclusion

Following *McMullen*, lawyers acting in both the real estate and corporate law context should exercise care in drafting to ensure that any ROFR right that is being granted reflects the intentions of the parties and covers all circumstances where the right is to be revived. If there is a wish for the renewal of the ROFR following its exercising, lawyers should take particular care to avoid its extinguishment, as affirmed in *McMullen*.

¹⁹ *Ibid* at para 15.

²⁰ *Ibid* at para 22.