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What You Need to Know About a Right of First Offer

Tenants, especially tenants of office space, often seek the ability to acquire more space in the future as their businesses grow. To accommodate these expansion needs, leases may contain rights such as the option to lease an additional designated space, rights of first refusal (ROFR) and/or rights of first offer (ROFO). These provisions attempt to balance the tenant's interest in expansion against the landlord's interest in having flexibility to lease the designated expansion space as it sees fit.

The main difference between an option to lease and a ROFR is that the former provides a tenant with an exclusive right to lease a designated space, whereas the latter provides a tenant with an opportunity to accept the terms that have been negotiated and agreed to between the landlord and a third party. When it comes to expansion rights, tenants want to have priority over other existing or prospective tenants to lease certain space. Tenants will prefer an option to lease or a ROFR for this very reason.

By contrast, a ROFO is a tenant's right to be the first to make an offer to or negotiate with the landlord when certain premises become available to lease. A ROFO gives the landlord more control over the process of offering additional space to a tenant because a simple ROFO only obliges the landlord to negotiate, there is no obligation to lease. (There are more complicated ROFOs that constrain the landlord's

flexibility after the tenant and the landlord have negotiated, but not concluded a deal.)

Let's Make a Deal, Please

A ROFO is a contractual right and therefore any rights and obligations of the landlord and tenant are governed by the wording of the provision. Where a lease contains a ROFO, it usually requires the landlord to notify the tenant of the availability of the designated premises. Typically, the tenant then has a specified period within which to notify the landlord that it is exercising its ROFO. Once the tenant has exercised its ROFO, usually a ROFO states that both parties must **negotiate** for a period as stated in the provision. Lastly, a typical ROFO contemplates that if the landlord and tenant fail to enter into a binding agreement to lease at the end of the negotiation period, the ROFO comes to an end and the landlord is free to lease the premises to another party.

Although there is ample recent case law in Canada to the effect that parties to a contract must perform their obligations in a good faith manner, it is important to note that a ROFO is, in effect, simply an agreement to negotiate.

In *P.P. (Portage) Holdings Ltd. V. 346 Portage Ave. Inc.*, the Manitoba Court of Appeal noted that an obligation to negotiate is only an obligation to communicate and there is no guarantee that good faith

negotiation will result in a lease. Therefore, having only the obligation to negotiate, the landlord could hold firm in its position regarding the material terms of the offer until the negotiation period lapsed. That did not trouble the Court of Appeal who recognized the ROFO for what it was: an agreement to agree.

Based on the current state of the law, a landlord who does not want to offer available space to a tenant, even in the face of a ROFO, is unlikely to meet severe consequences. The tenant must deal with the difficulty of claiming a breach of an unenforceable promise – an agreement to agree. Even if the tenant succeeds, damages (the value of the benefit lost or the opportunity to negotiate) will not be easy to prove, and are likely to be nominal or too uncertain to be enforced by the courts.

What Tenants Should Know

Landlords will concede to a ROFO in order to sweeten the deal during lease negotiations, but tenants should know that a ROFO does not provide as much of a “right” as its name would suggest. Unlike an option to lease or a ROFR, a ROFO merely requires a landlord to negotiate for a specified period. If the landlord likes what the tenant brings to the table, it can seriously entertain the tenant’s offer; however, if the landlord does not like the tenant’s offer, it can just ride through the negotiation period until the ROFO expires – leaving the tenant with little or no recourse. The bottom line is that if a tenant is looking to secure expansion rights, a ROFO will only provide a tenant with an opportunity to negotiate. If a tenant wishes to secure the right to expand,

it must strive for enforceable rights such as an option to lease or a ROFR.

Drafting Considerations

When drafting and negotiating expansion clauses, the specific space that is intended to comprise the tenant’s expansion premises should be precisely defined. The parties should strive for clarity with respect to the timeline and the manner in which the right to lease the extra space is to be exercised. Tenants will want the right to lease the expansion premises on the same terms and conditions as are contained in the offer or the lease, as the case may be. Landlords will seek market rates as they exist at the time the space is taken up. Similarly, a ROFR clause should define the space that is subject to the tenant’s rights and the process, including timelines, for exercising the right. Ideally a tenant’s right to elect to take the space will arise upon the landlord’s receipt of a bona fide offer from a third party that it is willing to accept, and also when the landlord makes an offer to lease that particular space and will be open for consideration and acceptance for a generous period of time. Landlords prefer tight time frames so as not to tie up the space. When it comes to expansion rights and ROFRs, tenants and landlords will have different points of view: tenants like these rights to be drafted as continuing rights. In other words, if the tenant does not elect to lease the extra space at the time it is offered by the landlord, the tenant’s right continues in full force and effect. On the other hand, landlords will draft these rights as one-time options that are exhausted and null and void immediately on rejection of the space by the tenant.



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