

Rights of first refusal in real estate transfers: Just an illusion?

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Most people active in the real estate market know of the concept of the right of first refusal, usually meaning that before a commonly held ownership share can be transferred to a third party, the other co-owner or owners have the (at least theoretical) right to purchase the proposed stake for sale on the same terms as contemplated for the proposed third party acquirer.

Rights of first refusal may exist either under the law or by contract. But in practice are these "rights" real, or are they nothing more than empty words bereft on any meaning at all?

Under real estate law, a right of first refusal exists:

- for a co-owner of indivisible shares, with respect to another co-owner seeking to sell its share to a third party who is not a co-owner in the real estate;
- for a land owner, if a building on land owned by the land owner is being sold;
- for a building owner, if a land plot under the building is being sold;
- for the state and municipal government, or special economic zones, under certain conditions provided by law.

What if an actual purchase and sale transaction is dressed up as a gift or an exchange or investment into the statute capital of a company (in lieu of cash)? The simple answer is that ordinarily such mechanisms are not subject to the right of first refusal.

Then there is the concept of buy-out rights. Buy out rights apply where a party has the option to buy out another party's ownership interest. Buy-out rights frequently exist where a party has not been given the opportunity to act on its already existing right of first refusal. Buy-out rights, as in the case of rights of first refusal rights, are not ordinarily triggered where the property is donated, exchanged, transferred under the settlement of a dispute or sold under an auction arising from a power of sale.

The long and short of it is that although theoretically rights of first refusal and buyout rights exist, in practice they are often circumvented. Usually the circumvention is in the form of a gift agreement or a property exchange agreement.

If the right of first refusal is circumvented using a property

exchange agreement or a gift agreement, theoretically one can challenge the transaction. Usually this would entail setting aside the transaction and reinstating the buy-out rights. This kind of action would ordinarily require bringing forth evidence that the true nature of the transaction is a purchase and sale, triggering the right of first refusal or buy-out. As a result, there might be a chance to have the transaction agreement set aside and deemed to be a purchase-sale agreement subject to buy-out rights.

The limitation period for such action is a year from the date when the impugned real estate transaction was registered in the land book. If the aggrieved party discovers that such a transaction has taken place only after the expiry of the one-year period from the date of the registration, then he or she is out of luck. It follows, then, that a periodic review of changes to the property as registered in the land book is a good idea. Otherwise the buyout right may simply expire and there may be a new, potentially unpalatable co-owner to deal with.

Why does any of this matter? Some argue on laissez faire philosophical grounds that rights of first refusal are simply wrongheaded to begin with; that everyone ought to have the right to buy and sell their property as they wish, without the state telling them that someone else has a first refusal or buy out right. Maybe so. In any case, some clarity in public policy would be helpful.

What is it that society really requires? Today, what we have is language in the law suggesting the existence of the concept of a right of first refusal, while in practice it is often a simple exercise to circumvent such right. If that is the case, on what grounds of public policy is such law on the books? To intentionally confuse people? To lull co-owners into a false sense of security that they have some kind of control over who becomes their co-owner? It is hard to justify having first refusal and buy out rights etched in the law when there are rarely any proper means to enforce such rights.

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