Interests in real property come in all shapes and sizes. Everyone remembers Property 101 and the discussion of the “bundle of sticks”. Sometimes parties want the ability to take or tag one of the sticks or the entire bundle in the future. This can be done by an option, right of first refusal (“ROFR”), or right of first offer (“ROFO”). Often parties enter into these agreements without considering whether they have an enforceable interest and the effect of that right on their property. Parties look to title insurance to protect their investment, but if they do not work with a title insurer prior to entering into the agreement or burdening their property, they may not have an insurable interest or may have placed a burden on their property which makes it difficult to sell or encumber the property in the future.  

I. Determining if the Interest is Insurable

A. Identifying the Interest to be Insured

In order to determine if an option, ROFR, or ROFO is insurable, a title insurer must determine what interest it is being asked to insure and how it is created. The type of right is not always determined by the title of the document or the identifying words. Some courts have found that what parties thought was an option was actually a right of first refusal and vice versa.  

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2 These materials are prepared with an understanding that the reader has basic knowledge of options, ROFR, and ROFO, and the differences between each. The focus of these materials will be the issues with title insurance coverage available for these interests and the impact of these interests on the ability to obtain title insurance.

3 See, e.g., Metropolitan Trans. Authority v. Bruken Realty Corp., 479 N.Y.S.2d 646, 655-656 (SCT, New York County 1984)(finding that “option” granted to railroad was a right of first refusal since it was subject to a condition precedent that the optionor first determine that it did not need the property for transportation purposes); Stuart v. D’Ascenz, 22 P.3d 540 (Colo. Ct. App. 2000), reh’g denied, 2000 Colo. App. LEXIS 1945 (Colo. Ct. App., November 9, 2000), cert. denied 2001 Colo. LEXIS 384 (Colo., May 14, 2001)(holding that a provision in a lease that contained a purchase price granted a right of first refusal and not an option to purchase because the holder of the right could not compel the sale of the property); Trecker v. Langel, 298 N.W.2d 289, 291 (Iowa 1980). But see
Whether the right is an insurable interest depends upon laws and regulations of the jurisdiction governing title insurance, the terms of the document creating the right, the facts of the transaction, and the underwriting guidelines of a title insurer. A title insurer will review the document creating the right to determine what it is being asked to insure and if the interest is insurable.

An option can be created by a separate instrument or included in leases, mortgages, deeds, or other instruments. It is critical to check the law of the jurisdiction where the property is located to determine if the interest is treated as an interest in real property and insurable. For example, some states treat a stand-alone option as a contract right and not an interest in real property but treat an option coupled with a real property interest (such as a lease) as an interest in real property. A 50 State Summary of jurisdictions and whether or not an option is an interest in real property is attached hereto as Schedule A. However, an option may still be insurable even if it is not considered an interest in real property.

A ROFR or ROFO is contained usually in another document. A common example is a lease which gives a tenant the right to match or make an offer if the landlord desires or attempts to sell the property. A ROFR or ROFO does not give the holder of the right the power to force the owner of the property to sell the real property as an option does. Instead, the holder of a ROFR or ROFO has the right to purchase the property only if the owner decides to sell the property or receives an offer to purchase the property. Courts have held that a ROFR contained in a lease is a covenant that runs with the land. See Megargel Willbrand & Co., LLC v. FAMPAT Ltd. Partnership, 210 SW3d 205, 210 (Mo App. E.D. 2006). So, if the right is a covenant that runs with the land, does that make it an insurable interest? Most title insurers are reluctant to insure a ROFR or ROFO because generally they are considered pure contractual rights and not interests in real property. Thus, it is important to check with the title insurer to determine that your ROFR or ROFO is an insurable interest if that is important for your transaction. If it is not an insurable interest, you may want to consider an option instead of a ROFR or ROFO.

B. The Effect of the Rule Against Perpetuities

Options, ROFR, and ROFO may be affected by the infamous rule against perpetuities which was part of the common law of most jurisdictions until the end of the twentieth century.

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*Tachdjian v. Phillips*, 568 S.E.2d 64 (Ga. App. Ct. 2002)(ruling that language in contract granting a “right of first refusal” for a fixed amount for a certain period of time and a negotiated amount thereafter was ambiguous and remanding the case to determine the parties intent).

4 The chart provided is a summary as of December 31, 2015. It shall not be construed as providing legal advice or a legal opinion.

after which most jurisdictions enacted their own rule or abolished the rule legislatively. See 10 Richard R. Powell, *Powell on Real Property*, Secs. 71.02 and 71.03 (2007). Thus, a title insurer must determine if the rule applies to the interest to be insured before the insurer can decide if the interest is enforceable and insurable.

A simple statement of the common law rule against perpetuities is that “no interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.” *Old Port Cove Holdings, Inc. v. Old Port Cove Condominium Assoc. One, Inc.*, 986 So.2d 1279, 1282 (Fla. 2008), *Iglehart v. Phillips*, 383 So.2d 610, 614 (Fla. 1980)(quoting John Chipman Gray, *The Rule Against Perpetuities*, Sec. 201 (4th ed. 1942)). The rule is not concerned with long term interests that are presently vested but with interests that vest too remotely. *Old Port Cove*, 986 So.2d at 1282.

Whether the rule against perpetuities applies to an interest depends upon the jurisdiction. Some jurisdictions apply the rule against perpetuities to interests in real property. 6 Other jurisdictions apply the rule to these interests even though they are contractual interests. 7 Some jurisdictions do not apply the rule against perpetuities to these interests on the basis that they are contractual rights and the rule applies only to interests in real property. These jurisdictions will review the interest by the rule of unreasonable restraints on alienation. 8 A few jurisdictions have a statutory rule against perpetuities which specifically

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7 See *Stuart Kingston v. Robinson*, 596 A.2d 1378, 1383-1384 (Del. 1991)(applying rule to preemptive rights which are contract rights and not direct interests in property); *Gange v. Hayes*, 237 P.2d 196 (OR 1951)(applying the rule to an option to repurchase contained in a deed although the same court previously held that an option does not pass an interest in the land in *Herdon v. Armstrong*, 38 P.2d 44 (OR 1934) but an option coupled with a lease is a covenant running with the land See *Texas Co. v. Butler*, 256 P.2d 259(OR 1953)); *Martin v. Prairie Rod & Gun Club*, 348 N.E.2d 306, 309 (ILL. 1976); *Anasae Realty Corp. v. Firestone*, 103 A.D.2d 707 (NY App. Div. 1st Dept. 1984)(applying rule to a right of first refusal); *Metropolitan Trans. Authority*, 479 N.Y.S.2d at 651-652 (finding that a right of first refusal appears to be “in the nature of a contractual right” but applying the rule); *Trecker*, 298 N.W.2d at 290; *Low v. Spellman*, 629 A.2d 57, 58 (Me.1993); *Mazzeo v. Kartman*, 560 A.2d 733, 737 (NJ App.Div.1989); *Melcher v. Camp*, 1967 OK 239, 435 P.2d 107, 112 (1967)(applying the rule against perpetuities to an option even though under Oklahoma law an option conveys no interest in the real property and finding that an option conveys and transfers an interest in the real property sufficient to invoke the rule against perpetuities); and *Village of Pinehurst v. Reg’l Inv. of Moore, Inc.*, 412 S.E.2d 645, 646 (N.C. 1992).

exempts these interests from application of the statute. However, even if the statutory rule against perpetuities does not apply, one must confirm that the common law rule does not apply in that jurisdiction as well (i.e., the statute did not expressly abrogate the common law rule or the interest was created before the statute was enacted).

II. Method of Insuring and Requirements to Insure an Option

Once the title insurer determines that the option is an insurable interest, the method for insuring the interest depends on how it is created, the laws and regulations of the jurisdiction in which the real property is located, and the underwriting guidelines of the title insurer.

A. Form of Coverage

The most common method to insure an optionee’s rights under a stand-alone agreement is to issue an owner’s policy for an insured amount equal to the consideration paid by the optionee for the option. Schedule A of the owner’s title policy is modified to show the insured interest is an option to purchase the real property identified in said Schedule A. If an option is contained within a lease, the option can be insured as part of the leasehold owner’s policy which insures the tenant’s interest in the lease. Some title insurers have a separate option endorsement that they issue with the policy which modifies the coverage in the policy and adds exceptions to the coverage that are specific to insuring an option (the specific exceptions are addressed in Section B herein). A sample of this endorsement is attached hereto as Schedule B.

If an option is not recorded, most courts will not enforce the option against third parties without notice. Usually, title insurers will not insure an option unless the document creating the option (or a memorandum or notice thereof which includes the option) is recorded in the public record. Perpetuities and unreasonable restraints on alienation to right of first refusal; Hartnett v. Jones, 629 P.2d 1357, 1360 (Wyo. 1981); see also Weber v. Texas Co., 83 F.2d 807, 808 (5th Cir.1936) (“The option under consideration is within neither the purpose nor the reason for the rule.”); cf. Great Bay Sch. & Training Ctr. v. Simplex Wire & Cable Co., 559 A.2d 1329, 1331 (N.H. 1989) (stating that the rule does not apply to all preemptive rights, just those that “pose a substantial restraint on alienation”); Power Gas Mktg. & Transmission, Inc. v. Cabot Oil & Gas Corp., 948 A.2d 807 (Pa. 2008) (holding that a right of first refusal in an oil and gas lease agreement is not subject to the rule against perpetuities; stating “we also question whether, in the first instance, rights of first refusal ... ever concern propertied estates such that they should be brought within the rule against perpetuities”).

9 Buck v. Banks, 668 N.E.2d 1259, 1261 (Ind.Ct.App.1996); Atlantic Richfield Co. v. Whiting Oil and Gas Corp., 320 P.2d 1179, 1184 (Colo. 2014);

10 See Bucks, 668 N.E.2d at 1261; Atlantic, 320 P.2d at 1180-81;

11 Remember, as noted in Section I (A), a ROFR or ROFO is generally not insurable, and so this section will address coverage for options only.

12 Most landlords do not want to grant a tenant any right to purchase the property but prefer a ROFR or ROFO to an option since the landlord’s goal is to keep the property and the income stream produced by the rent.
records of the jurisdiction where the real property is located. Some title insurers may insure an unrecorded option but will take exception for any loss, cost, or damage or claim of lack of marketability related to or arising from the failure to record the option.

For mortgage loans, some lenders will include an option to purchase an interest in mortgaged real property for the amount of the principal balance remaining on the loan as an additional remedy in the event of the borrower’s default. However, the lender may have a problem enforcing that option since most courts would view the option as an attempt to undermine the mortgagor’s right of redemption which is available in most states. This is commonly referred to as “clogging the equity of redemption.” It is unlikely that a court will allow a lender to circumvent the mortgagor’s right of redemption with such a purchase option. Thus, a title insurer may not be willing to insure this option right in favor of lenders.

In jurisdictions where an option is not an insurable interest for the issuance of a title insurance policy, one may think that the right may be insurable with a UCC policy as a personal property interest. A UCC policy for a purchaser does not insure the ownership of personal property but only what is filed against the personal property. Unfortunately, the Uniform Commercial Code does not provide for the filing of an option, or for a ROFR or ROFO, and so there is no UCC filing to insure.

B. Exceptions

In addition to the exceptions specific to the property, the facts of the insured transaction and the underwriting guidelines of the title insurer may cause it to require additional exceptions to a policy or endorsement insuring an option interest including, but not limited to:

- Rejection of the option under the provisions of the Bankruptcy Code.

- The failure of the insured option holder to receive all or part of an award entered in a condemnation proceeding unless failure to share in said award stems from a court order or judgment which constitutes a final determination and adjudges the option invalid or incapable of specific performance.

- The failure of the insured at the time of payment of the option price when exercising the option either to have obtained proper conveyances and releases from all persons then having an interest in said land or a lien or

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14 The grantor of an option to purchase may avoid the option in a bankruptcy proceeding as an executory contract. 11 U.S.C.A. Sec. 365(a).
encumbrance thereon (the determination as to the identity of such persons and the nature of the interest, lien or encumbrance owned or claimed, to be at the expense of the insured) or to have obtained a court order or judgment which constitutes a final determination and determines those persons and interests entitled to receive the option price.\textsuperscript{15}

- Attorney's fees and costs in connection with the proceedings mentioned in the subparagraph immediately above, or in connection with an action to enforce the option, excluding attorney's fees incurred to defend an attack on the validity or enforceability of said option.

- Any lien or right to a lien for services, labor or material heretofore or hereafter furnished, imposed by law.

- Failure of the insured to fulfill the terms and conditions of the option agreement.

If an option is not an interest in real property in the jurisdiction, it may still be an insurable interest if it is a valid and enforceable agreement and meets the title insurer’s underwriting guidelines. Title insurers may add additional exceptions in these instances and provide that a loss under the policy does not include:

- Expenses required to enforce the option and to obtain a transfer of title from the party in whom title to any interest in the land is vested at the time of exercising the option, or

- Expenses required to obtain valid conveyances or releases of any rights, interests, or liens related to the land which appear of record or are known to the insured at the time of exercising the option.

- Matters recorded subsequent to the date of the policy and prior to the date the option is exercised.

The title insurer may modify the measure of loss or damage under the terms of the policy to the excess of the fair market value of the property at the time the insured attempts to exercise the option (or when a lawsuit contesting the validity of the option is filed if prior to the attempted exercise) above the price at which the insured could acquire the property by the exercise of the option, plus the unreimbursed portion of the consideration given by the insured to obtain the option.

\textsuperscript{15} Note, a title policy issued to insure an option insures the validity and enforceability of the option and not the exercise of the option.
C. **Endorsements**

The availability of endorsements is subject to the facts of a transaction, the underwriting guidelines of the title insurer, and the laws and regulations governing title insurance of the jurisdiction in which the property is located. Endorsements that title insurers may issue in connection with options include:

1. **ALTA 46 Option endorsement** – This is a recently approved endorsement with limited coverage that can be used where an option is not an interest in real property that is coupled with a real property interest that is being insured. A sample of the endorsement is attached hereto as Schedule C.

2. **ALTA 9.6-06 Private Rights – Loan Policy** - This endorsement does not give coverage for the option but insures that there are no private rights that exist or that would interfere with the enforceability or priority of the insured mortgage. The endorsement contains two defined terms. "Private Right" is defined in Section 2. b. to mean (i) a private charge or assessment; (ii) an **option to purchase**; (iii) a **right of first refusal**; or (iv) a right of prior approval of a future purchaser or occupant. Section 3 of the endorsement provides coverage in the event that a Private Right contained in a Covenant (defined as a covenant, condition, limitation or restriction contained in a document or instrument in effect at the Date of Policy) results in the invalidity, unenforceability or lack of priority of the lien of the insured mortgage or causes a loss of the insured's title acquired in satisfaction of the lien of the insured mortgage, subject to any exceptions in Schedule B of the policy. Excluded in Section 4 of the endorsement is loss arising from any covenant, condition, limitation or restriction: (a) contained in an instrument creating a lease; (b) relating to obligations to perform maintenance, repair or remediation on the insured real property; or (c) relating to environmental protection of any kind, including hazardous or toxic matters, conditions, or substances. Section 4.d allows the title insurer to further limit the coverage provided in the endorsement by specifically excepting any Private Right (as defined in the endorsement) for which coverage is otherwise provided in the policy or endorsements by listing any such Private Rights contained in an identified exception(s) in Schedule B of the policy. Thus, if the title insurer wants to exclude a Private Right from the coverage of the ALTA 9.6-06 endorsement, the excluded Private Right must be identified in Schedule B of the policy.

The ALTA 9.6.1-06 endorsement is the same as the 9.6-06 endorsement except that the reference in Section 2(b)(i) is to a private charge or assessment due and payable at Date of Policy. It is intended for use in those states in which an assessment may gain priority over the lien of an insured mortgage.
Samples of these endorsements are attached hereto as Schedule D.

3. **State Specific Option endorsements** – Some states have their own state-specific endorsement for insuring options, and so it is recommended that one confirm with the title insurer whether or not a state-specific option endorsement is available (or required) and the coverage that it offers.

### III. Impact of Options, ROFRs, and ROFOs on a Seller’s or Borrower’s Interest in Real Property

Property owners may grant options, ROFRs, and ROFOs, and encumber their real property without thinking about the consequences of their actions. These rights have a chilling effect on the owner’s ability to market its property. A title commitment for the sale of real property burdened by these interests will require a waiver from the holder of the interest. Potential purchasers may not want to put the time and effort into due diligence for a property that they may lose if the holder exercises its right. Furthermore, it may be difficult to clear these rights from the title in order to sell to a third party purchaser. No matter how well drafted the right (and many are not), there are issues in the exercise that cause problems for future transactions. The risk is a total failure of title if there is a successful future claim by the holder of the interest. Since land is unique, cash may not be adequate compensation.

For example, many clauses provide that a failure of the holder of the right to respond within 30 days after receipt of notice is deemed a waiver. At first glance this is a brilliant idea to handle the problem of a holder that refuses to respond to a notice. If the holder does not respond, the interest is waived and the seller can close the potential transaction. The problem is establishing that notice was given properly and proving that the holder did not exercise the right. Should we expect a title insurer to rely upon the representation of the property owner that the notice was sent in accordance with the terms of the agreement/lease and that a response was not received? The title insurer would have to rely on the representations of a party that has a motivation to see that the transaction is closed. Furthermore, many owners are large and complex entities with several different offices and departments. The holder may send the notice of exercise to a different department or official, or it may sit in someone’s in-box that is on vacation. While the notice provisions of the agreement or lease which creates the right should be clear as to how the notice of exercise is given, one does not want to rely on improper notice of exercise as a basis for fighting the exercise at a future date. While drafting the option, ROFR or ROFO, think about ways that you can provide independent verification of the terms of the interest such as requiring representations in a tenant estoppels.

Another title issue with clearing these types of rights is whether an option, ROFR, or ROFO is a continuing right or if the right is lost if not exercised. If the language is not absolutely clear that the right is a one-time right that is terminated if not exercised, a title insurer
may determine that the right is a continuing right that must remain as an exception to title even if not exercised for the insured transaction. A purchaser may not want to acquire the property with that continuing burden because of the previously mentioned chilling effect on the ability to market the property.

Most lenders require subordination of an existing option, ROFR, and ROFO prior to making a mortgage loan since the pre-existing right would have priority over the mortgage. If not subordinated, and the agreement creating the interest does not expressly exclude a foreclosure or deed-in-lieu as triggering events, the holder of the right may argue that a foreclosure or deed-in-lieu triggers the ROFR or ROFO. Even if the document creating the interest clearly excludes a foreclosure or deed-in-lieu, if not subordinated, the property would continue to be subject to the option, ROFR or ROFO after a foreclosure. To protect owners, counsel may include self-subordinating language in the agreement creating the right so that the owner is not “held hostage” by the interest holder when the owner wants to refinance the property. Self-subordinating language is not a guaranty that the property owner will not need to obtain a subordination in the future. Whether or not a title insurer will rely upon such self-subordinating language will depend upon the language itself, the facts and circumstances of the proposed transaction, the law of the jurisdiction in which the property is located, and the underwriting guidelines of a the title insurer.

Beware of statutory or hidden ROFR or ROFO in several jurisdictions. For example, when working with real property owned by a religious institution or church, the bylaws of the organization may give a ROFR or ROFO to a national or regional church body from which a waiver must be obtained. Also, laws in some states grant statutory ROFRs to gas station franchisees under certain circumstances.

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16 An option can be exercised by the holder of the right upon the terms and conditions as set forth in the option regardless and is usually not dependent upon a triggering event.

17 There is a school of thought that the concept of subordination only works with like interests, and so you may want to have the interest holder join the mortgage as well.

18 California Business and Professions Code Sec. 20999.25, CT Gen. Stat. Sec. 42-133mm, and N.J. Stat. Sec. 56:10-6.1. This is not an exhaustive list, and so check the law of the jurisdiction to confirm if there are hidden statutory interests.