

I. Options

(a) General

DiCastrri defines an option as:

"...a right acquired ex contractu to accept or reject a present offer within a limited, or, as the case may be, a reasonable time in the future, and, when otherwise validly constituted, vests in the optionee an interest in land, i.e. forthwith upon the granting of the option, the optionee, upon the occurrence of certain events, solely within his control, can compel a conveyance of the land to him."¹

It is important to note that both the Statute of Frauds and the rule against perpetuities are applicable to options. Therefore, the option agreement must be put in writing and signed by the parties or their agents lawfully authorized in writing. As well, care must be taken in the drafting of an option to ensure that the option must be exercised not later than 21 years after some life in being at the creation of the option. Otherwise, the option will be void ab initio. The Supreme Court of Canada held in Harris v. M.N.R. (1966), 57 D.L.R. (2d) 403, that once an option clause creating a land interest is found to be void as infringing the rule against perpetuities, there is nothing left in the agreement in the nature of a personal contract that could be specifically enforced.

(b) When Options are Appropriate

An option is an *unconditional contract* which binds the optionor or potential vendor, but leaves the optionee or potential purchaser, free to chose whether to exercise the option within the prescribed time period in the option. Thus, one of the more-obvious advantages to an optionee of a long-term purchase option at a specified price is that an optionee receives the benefit of a potential increase in the value of the property during the existence of the option. For an optionee, options are preferable to a long-term agreement of purchase and sale. While an optionee may be speculating that a property could increase in value, he can at the same time avoid the disadvantage of a possible decrease in the value of the property before the closing date.

An optionor or vendor, however, may prefer a long-term agreement of purchase and sale as opposed to an option. Under a long-term agreement of purchase and sale, the vendor is assured the sale will take place at a fixed price. While an optionor cannot control whether an option is exercised, his right to sell or encumber his property is hampered by the existence of an option.

He is also unable to take advantage of any better purchase offer that may arise.

There are various circumstances where an optionee may desire to have an option on property:

A developer wishing to assemble a tract of land for a shopping centre would not want to be bound by a number of agreements of purchase and sale on the various parcels of land making up the tract. In this situation, options on the various parcels would be preferable as the optionee would not want any of the parcels of land if he were unable to purchase all of the parcels.

A prospective purchaser may wish to buy time before he makes his final decision whether to purchase. An option is an appropriate vehicle for a purchaser who wants to tie up the property while he does some further investigation, without liability to purchase.

In some situations, a tenant under a lease may have a need for a purchase option. For example, an industrial tenant might have to make costly renovations and installations which would be of little use to the landlord or any successive tenant. If the tenant feels that the landlord will try to increase the rent on the property unreasonably at renewal, he can exercise his option.

Also, a retail *tenant might* wish to have a purchase option in a lease to prevent a competitor from outbidding him when it came time to renew the lease. In these

circumstances, an option would be a device to protect a leasehold interest.

(c) Should the Option Contain the Agreement of Purchase and Sale which is Triggered on Exercise of the Option?

An exercise of an option creates an irrevocable contract of sale, therefore, the party should provide for the usual terms of such contracts. Friedman suggests that a contract of sale be drawn up with all its usual provisions and be attached to the option. The parties should at least provide for the usual terms of such contracts, i.e. price, terms of payment, time and place of closing, nature of title to be given, type of deed, and any adjustment to be made on closing. Also, thought should be given to the option's right to encumber in the interim by mortgages, leases, easements, etc.²

DiCasteri supports this view. He states that on an exercise of an option, the optionee is entitled to a deed in accordance with the terms of the option.³ Therefore, the terms of the option should be clearly expressed.

Any clauses or conditions precedent to the exercise of the option which are desired by the optionee should also be inserted. For example, common conditions precedent would include requirements that the property be zoned commercial, that appropriate financing be arranged, favourable results of engineering reports to be obtained, etc.

(d) Should Options be Recorded?

Options should be recorded. An option is an encumbrance on the land. An optionee can lose his right to specific performance of the option if non-registration of the option is coupled with a conveyance by the optionor to a bona fide purchaser without notice. However, non-registration would not invalidate a claim for damages against the optionor.⁴

As to the priorities on recording, it would appear that if an option is recorded prior to other encumbrances, the subsequent encumbrances or conveyances would take subject to the option. For example, if a subsequent mortgage were foreclosed, a purchaser at a foreclosure sale would take subject to the option agreement.

If an option is recorded, it will have to be postponed on refinancing if the new mortgagee wishes to have a first charge on the property. It is our opinion that unless the option is postponed, it would hinder the optionor obtaining financing from a conventional lender.

(e) If a Term of Option is Breached, or if a Term of a Long Term Lease with an Option to Purchaser is Breached, is it Necessary to go through a Formal Foreclosure Procedure?

On principal, no notice of termination by the optionor is required where as a result of the default of the optionee in performance of a condition precedent, the option never comes into existence.⁵

If a term of a lease with an option is breached, it may or may not terminate the option. Re-entry by the landlord with the consequent termination of a lease generally terminates the option. But, this is probably not true of a mere default under some other term of the lease as covenants in a lease are generally independent.⁶

(f) Is a Lease with an Option to Purchase the same as an option?

There are some differences between an option contained in a lease and an option to purchase:

While an option must be supported by separate consideration, an option contained in a lease may be valid without separate consideration.⁷

Where an option contained in a lease does not set a fixed time period for exercise of the option, there is an inference drawn that the length of time for exercise of the option was intended to be the same as the length of the lease.⁸

An option to purchase in a lease is incidental to the relationship of landlord and tenant

and is not a term of the tenancy. An option to purchase is a valid and separate contract which will not survive the expiration of a lease unless there is specific language within the original lease or renewal document extending it or indicating that such is the intention of the parties-9

(g) Appropriate Option Fee

I suggest that the following are some factors to be taken into consideration on calculation of an option fee:

- (1) the value of the property on which the option has been given;
- (2) length of the term of the option;
- (3) likelihood of an increase in the value of the property;
- (4) number of conditions precedent in the option, i.e., this relates to the likelihood of the option being exercised - if it is more unlikely that it will be exercised, the fee should be increased;
- (5) marketability of the property, i.e. if many people are interested in the property then why should the optionor give an option unless the fee is non-refundable and is substantial.

In general, an option fee is forfeited if the option is not exercised; however, on exercise of the option, the fee is usually credited to the purchase price.

II. Rights of First Refusal

(a) General

"A 'right of first refusal' or a 'first option to purchase' is not an absolute option but one which is conditional and contingent upon the will or desire of the owner to sell. Accordingly, it does not impede the owner's right to alienate the land; the sole right of the quasi-optionee being to accept or reject as a preferred purchaser when the owner is ready to sell."¹⁰

Thus, a right of first refusal does not hamper the owner's right to alienate or encumber his property. The owner is also free' to take advantage of a better purchase offer.

A person who contracts to receive a right of first refusal is entitled only to receive notice of the optionor's willingness to accept an outside offer to purchase an of the price offered. The right is then conditional or contingent upon the owner. In order to exercise the option, the optionee must match the outside offer.

While this type of option does not hamper the owner's right to sell his property, it should be noted that a right of first refusal can still prejudice an optionor as it could have a chilling effect on a prospective buyer who would not wish to invest time and money in *investigating* the property if a right of first refusal had been granted. If acting for a vendor you should always try to keep the term for exercising an option as short as possible.

(b) When Rights of First Refusal Are Appropriate

A right of first refusal is. a somewhat "weaker" form of an option to purchase and thus may be a second alternative for an optionee who is unable to obtain an option to purchase. It is also a more desirable alternative for an optionee who is not primarily interested in purchasing the property, but wishes to protect an interest in the land .

Rights of first refusal are frequently found in .leases. It offers some protection to a tenant in a residential or commercial property where a tenant has invested time and money in developing the property for his own use. The tenant wishes to protect his leasehold interest and is not primarily interested in purchasing the property. Therefore, if a

tenant feels threatened by a purchase of the property by a third party under a bona fide offer, he can then match the offer and be entitled to purchase.

Another situation where a right of first refusal would be appropriate is where an optionee is the owner of a neighbouring property and thus, has some interest in the ownership or development of that property. For example, in a residential area, a neighbour may be interested in retaining the buffer zone of a grassy area between the properties or in preventing an undesirable development of the land. He then has the right to match the offer and purchase it to protect his situation.

(c) Should Rights of First Refusal be Recorded?

In Canadian. Long Island **Petroleums Limited v. Irving Industries**, [1974], 6 W.W.R. 385, the Supreme Court of Canada held that a right of first refusal is not an interest in land, rather, it is a mere contractual interest. Therefore, registration of a right of first refusal will not act as an absolute protection of the optionee's interest.

However, successors in title to the grantor of the right of first refusal may still be bound if they take the property with actual notice of the right. Therefore, registration of the right of first refusal would provide notice to the successor in title and would protect the optionee's right in this particular circumstance.¹¹

However, as a right of first refusal is not an interest in land, registration will not protect the optionee's interest over and against subsequent encumbrancers. Therefore, it would appear the consent of encumbrancers is not required to put a right of first refusal on a property. Neither do rights of first refusal have to be postponed on refinancing, as they would not affect a subsequent encumbrancer's priority.

(d) Appropriate Fee for Right of First Refusal

In consideration of the weaker force of a right of first refusal in relation to that of an option to purchase, the fee for a right of first refusal should be scaled down accordingly.

III.
Precedents

1. Option to Purchase;
2. Right of First Refusal;
3. Sample clause for Right of First Refusal in Lease.

These precedents are made available for instructional purposes only. Although every effort has been made to ensure accuracy, there is no guarantee that there are no errors or omissions.

THIS OPTION AGREEMENT made this 12th day of February, 1987.

BETWEEN:

SAM SPADE, herein called "Optionor"
OF THE FIRST PART
- and -
BROWN COMPANY LIMITED, herein called "Optionee"
OF THE SECOND PART

THIS INDENTURE WITNESSETH THAT:

1. IN CONSIDERATION of the sum of Five Thousand Dollars (\$5,000) now paid by the Optionee to the Patterson Kitz in trust, solicitor for

the Optionor, the receipt of which is hereby acknowledged by the Optionor, the Optionor hereby gives to the Optionee a sole and exclusive option (hereinafter referred to as the "Option") irrevocable within the time limited herein for acceptance, to purchase, free from encumbrances, all those certain lands and premises owned by the Optionor located at 1672 Black Street, Dartmouth, Nova Scotia, having a frontage of 175 feet more or less on Black Street, with a depth of 340.5 feet more or less along the southerly boundary and depth of 280.22 feet more or less along the northerly boundary and 181.75 feet more or less along the westerly boundary, comprising an area of 55,930 square feet more or less, and more particularly described in Schedule "A" attached hereto, herein called "Land".

2. THE OPTION SHALL BE OPEN FOR ACCEPTANCE up to and including 5:00 o'clock P.M. on the 12th day of February, 1988, and may be accepted either by a letter delivered by hand to the Optionor, or by letter sent registered mail, addressed to the Optionor in care of Sam Spade, 2500 Oxford Street, Halifax, Nova Scotia. Should this option be exercised by registered mail, notice thereof shall be conclusively presumed to have been given by the Optionee at the actual date and time of mailing in the Post Office.

3. The sum of Five Thousand Dollars (\$5,000) paid by the Optionee to the Optionor as consideration for the giving of this option shall be allowed as part payment of the purchase price above-mentioned. If the Optionee does not accept the option, the said sum of Five Thousand Dollars (\$5,000) paid as consideration for the giving of this option shall be forfeited by the Optionee to the Optionor, subject as hereinafter set forth.

(a) The sum of Five Thousand Dollars (\$5,000) paid by the Optionee to the Optionor shall be repaid to the Optionee upon his request **in writing and the Optionee may elect, without liability for any costs or damages, that** the resulting Agreement of Purchase and Sale shall be null and void and no longer binding upon the parties, if before the closing date hereinafter set forth, the following conditions are not fulfilled:

(i) The Optionee shall obtain all necessary building permits, sign permits and operating permits, which permits are to provide the Optionee with the authority to construct, advertise and operate a commercial outlet;

(ii) The Optionor's property shall be free of all restrictions preventing the Optionee's use of the property as a commercial outlet;

(iii) All zoning by-laws applicable to this property shall be amended, if necessary, and at the expense of the Optionee to provide zoning satisfactory to the Optionee in order to permit the Optionee to use the property as a commercial outlet. The Optionor shall act reasonably to cooperate with the Optionee in all necessary applications for zoning changes and in obtaining any consents that may be required in connection with this provision;

(iv) The Optionor, where required to do so by any planning, subdivision or land use control legislation, in order to make this transaction effective shall obtain at its expense the relevant consent or approval of the appropriate governmental body having jurisdiction.

4. Upon acceptance by the Optionee, this option shall then constitute an agreement of purchase and sale, subject to the following terms and conditions:

(a) The purchase price of the said Land shall be the sum of Two Hundred Thousand Dollars (\$200,000), which shall be paid in cash on the date of closing;

(b) Any prepayment penalty charge by the existing first mortgagee shall be paid by the Optionee in addition to the purchase price;

(c) vacant possession of the property shall be given to the Optionee on the closing. The closing date shall not be later than thirty (30) days from and including the date of acceptance of the option by the Optionee (hereinafter called the "Closing Date");

(d) The Optionor shall not be bound to produce any evidence of title except as is in its possession or under its control;

(e) For the purposes of determining value pursuant to the Income Tax Act, the value of the land shall be Fifty Thousand Dollars (\$50,000) and the value of the buildings erected thereon shall be One Hundred Fifty Thousand Dollars (\$150,000);

(f) The Optionor is to furnish the Optionee with a metes and bounds description of the property which is the subject of this Agreement, after receipt whereof the Optionee is allowed thirty (30) days from the acceptance of this option to **investigate the title to the property, which** it shall do at its own expense. If within that time any valid objection is made in writing to the Optionor, which the Optionor shall be unable to remove, and which the Optionee shall not waive, this Agreement shall be null and void and the Five Thousand Dollars (\$5,000) paid by the Optionee to the Optionor as consideration for the giving of this option shall be returned to the Optionee, without interest, and without liability by the optionor for any expense incurred or damages sustained by the Optionee;

(g) The conveyance of the property which is the subject of this option shall be by Warranty Deed, drawn at the expense of the Optionor, to be delivered on payment of the purchase price on the closing date. The said property is to be charged free from dower and other encumbrances;

(h) All buildings and equipment upon the real property shall be and remain at the risk of the Optionor until closing;

(i) All adjustments of insurance, rentals, mortgage, interest, taxes, fuel and water rates to be apportioned and allowed to the date herein fixed (including without limitation the generality of the phrase "municipal improvements", betterment charges and capital charges for utility or municipal services) completed as of the closing date, whether billed or not, are to be assumed by the Optionee in addition to the purchase price. The property shall be at the risk of the Optionor until closing;

(j) During the duration of the option and the agreement of purchase and sale, the Optionor shall not encumber the property in any manner;

(k) Any tender of documents or money hereunder may be made upon the Optionor or the Optionee or any party acting on their behalf, and money may be tendered by negotiable cheque certified by a chartered bank or trust company;

(l) There are no representations, warranties, collateral agreements or conditions relating to the property except as specified herein;

(m) Time shall, in all respects, be of the essence of this Agreement;

(n) This Agreement shall enure to the benefit of and be binding upon the parties hereto, their respective heirs, executors, administrators, successors and assigns;

(o) This Agreement is to be read with all changes of gender or number required of the context.

IN WITNESS WHEREOF the parties hereto have executed These Presents the day and year first above written.

SIGNED, SEALED AND DELIVERED)
in **the presence of:**)

SAM SPADE
BROWN COMPANY LIMITED
Per:
PROVINCE OF NOVA SCOTIA
COUNTY OF HALIFAX

ON THIS day of February, 1987, before me, the subscriber, personally came and appeared a subscribing witness to the foregoing Indenture, who, having been by me duly sworn, made oath and said that SAM .SPADE, one of the parties thereto, executed the same in his presence.

A Barrister of the Supreme Court of Nova Scotia

PROVINCE OF NOVA SCOTIA
COUNTY OF HALIFAX

ON THIS day of February, 1987, before me, the subscriber, personally came and appeared a subscribing witness to the foregoing Indenture, . who, having been by me duly sworn, made oath and said that BROWN COMPANY

LIMITED, one of the parties thereto, caused the same to be executed by and at the same time caused its Corporate Seal to be thereunto affixed by the hands of. its said and in his presence.

A Barrister of the Supreme
Court of Nova Scotia

Footnotes:

- 1 DiCatri, p. 144
- 2 Friedman, p. 635
- 3 DiCatri, p. 151
- 4 DiCatri, p. 155
- 5 DiCatri, p. 157
- 6 Friedman, p. 169
- 7 DiCatri, p. 153
- 8 DiCatri, p. 156
- 9Insight, Tab VIII, p.12
- 10 DiCatri, p. 148
- 11 DiCatri, p. 148