

Court of Chancery Considers Bundled Assets and Rights of First Refusal

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In the context of limited liability companies, a right of first refusal (ROFR) limits the ability of an equityholder to transfer equity to a third party without first offering other existing equityholders a right to match the third party's offer. Occasionally, equityholders choose to bundle equity they propose to transfer to a third party with a number of other assets. Such bundling can impair rights of first refusal in at least two manners. First, bundling requires an allocation of value as between the equity subject to the ROFR and the other assets. If no allocation methodology is specified in the contract, then the transferring party could attempt to overallocate value to the equity subject to the ROFR. Although courts have historically been willing to reevaluate overallocation in light of the transferor's ulterior incentives, see, e.g., *Gleason v. Norwest Mortgage*, 243 F.3d 130 (3d Cir. 2001) (remanding to district court for hearing and fact finding on the price of a bundle subject to a ROFR), uncertainty regarding a court's re-allocation weighs heavily on a ROFR holder contemplating exercising such right. Second, by introducing both a potentially divisible bundle of assets and a delay mechanism through the allocation, bundling provides the transferring



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party with additional time to evaluate whether the ROFR holder will exercise its right or challenge the allocation; the transferring party may then choose to cancel the proposed sale in its entirety, or partially cancel the sale by coaxing the proposed third-party purchaser to exclude from their offer the assets not subject to the ROFR.

In *HUMC Holdco v. MPT of Hoboken TRS*, C.A. No. 2019-0972-KSJM (Del. Ch. July 2, 2020), the Delaware Court of Chancery confirmed a number of default rules related to bundling, including the scope of ROFRs and their revocability. This case involves an alleged breach of an LLC's operating agreement, which granted a ROFR to HUMC Holdco, LLC (the ROFR Holder) with respect to the LLC membership interests held by MPT of Hoboken TRS, LLC (the Transferor). Although the

operating agreement required any would-be transferor to notify its fellow members of a qualifying "Offer," the Transferor failed to notify the ROFR Holder when the Transferor entered into an agreement to transfer its membership interests to a third party (the Purchaser). As relevant here, the Purchaser's agreement to acquire the Transferor's membership interests was conditioned on its acquisition of real estate owned by two of the Transferor's affiliates.

Matching the Whole Bundle?

Flipping the script of typical ROFR cases, the ROFR Holder here argued that the operating agreement entitled it to acquire the Transferor's membership interest *and* the real estate that was the subject of the Transferor-Purchaser purchase agreement—i.e., to match the complete bundled third-party offer. Pursuant to the

operating agreement, the ROFR Holder had 15 days after receiving a qualifying Offer to exercise its right to “purchase all (but not less than all) of the membership interests proposed to be sold upon the same terms and conditions stated in the Offer.”

The court disagreed. Adopting the reasoning of *USA Cable v. World Wrestling Federation Entertainment*, 766 A.2d 462 (Del. 2000), the court concluded that the scope of a ROFR “shall be construed as to the subject matter of the agreement containing the right, unless the parties expressly agree otherwise.” Applying the “whole-text canon” utilized in *USA Cable* to consider the context of the operating agreement to determine the meaning of its words, the court found that it was unreasonable to conclude the operating agreement intended to extend the scope of the ROFR to include the real estate when neither the limited liability company, nor any of its members, owned the subject real estate.

Allocating Value Within the Bundle

Notwithstanding its narrow interpretation of the scope of the ROFR at issue, the court denied the Transferor’s motion for judgment on the pleadings. The court acknowledged that, to enable the ROFR Holder to match the Purchaser’s offer, the court would have to allocate the Purchaser’s consideration between the equity interests falling within the scope of the ROFR and the bundled real estate. On the pleadings, however, the court found it reasonably conceivable that the purchase price offered by the Purchaser was not based solely on the value of the membership interest, but rather

involved considerations affected by the nature of the package deal—e.g., synergies from owning the bundle of assets or tax optimization. The court determined that these were fact issues that could not be resolved on the pleadings.

Implications of a Triggered Right of First Refusal

The opinion also sheds light on how Delaware courts might view the effects of the withdrawal of third-party offers vis à vis the holders of ROFRs. The Transferor argued that the Purchaser withdrew its offer to purchase the Transferor’s membership interest in the LLC, thus disabling the ROFR. The ROFR Holder countered that the ROFR opened an irrevocable window for it to exercise its purchase right, effectively creating an option contract. The Transferor disagreed, citing to *LIN Broadcasting v. Metro-media*, 74 N.Y.2d 54 (1989), for the proposition that ROFRs are not intended to force the owner to sell, but to prohibit the transfer of property without complying with the restriction. The court declined to reach this issue, which appears to be unsettled in Delaware, citing many factual disputes foreclosing judgment on the pleadings as to what constitutes the operative qualifying offer. Nonetheless, in *dicta* the court telegraphed that it would likely agree with *LIN Broadcasting’s* rationale and the Transferor’s argument here, thus providing valuable insight into how to effectively draft ROFRs.

Key Takeaways

Drafters should consider specifying whether a selling equityholder’s delivery of notice of a third party’s offer is itself an irrevocable offer to

the ROFR holders to sell on such terms. Although the court did not decide the effects of an abandoned third-party offer as it relates to the holder of a ROFR, the court appears to lean in the direction that abandonment would neutralize the ROFR.

In the context of LLCs, the scope of a ROFR extends only as far as the subject matter of the LLC agreement; therefore, a ROFR will not necessarily extend to a bundle of assets being sold, when only one asset is subject to the ROFR. Parties intending to extend the scope of a ROFR beyond an LLC’s assets or equity should be wise to do so expressly.

When a seller agrees to transfer a mixed bundle of assets, some of which are subject to a ROFR and some of which are not, the parties “obscure the court’s ability to determine which terms and conditions need to be matched.” Nonetheless, a court will most likely determine such allocation on its own. If parties wish to avoid a court involving itself in such determination, they may consider detailing how value will be allocated among assets that are inside and outside the scope of the ROFR.

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