January 1985

Contract Law - Fixed Price Option vs. Right of First Refusal: Construction of a Dual Option Lease - Texaco, Inc. v. Creel

Mark Scruggs

Follow this and additional works at: http://scholarship.law.campbell.edu/clr

Part of the Contracts Commons

Recommended Citation
NOTES


INTRODUCTION

This note focuses on the proper interpretation of what has been referred to as a dual option lease; that is, a lease containing both an option to purchase at a fixed price and a right of first refusal. The issue is the relationship between the fixed price option and the right of first refusal. Does the lessee’s failure to exercise the right of first refusal extinguish his rights under the fixed price option, effectively forcing him to meet any bona fide third party offer or risk the loss of his investment? Or, are the two provisions independent of each other; the exercise, or non-exercise, of one having no effect upon the other?

This issue has prompted a sizeable amount of litigation with two interpretations emerging as predominate. One line of cases holds that the fixed price option and the right of first refusal are completely independent of each other and the exercise of one has no effect on the other.1 Another line of cases holds that the options are dependent on each other; the exercise of one, or the failure to exercise one, extinguishes the lessee’s rights under the other.2

The North Carolina Supreme Court was faced with a dual option lease in Texaco, Inc. v. Creel.3 The court held that the lessee’s failure to meet a bona fide third party offer under the first refusal option did not extinguish the lessee’s right to exercise the fixed price option at any time during the lease period.4 In doing so, the court followed Butler v. Richardson5 and the line of cases holding that the dual options are separate and operate independently of

2. Shell Oil Co. v. Blumberg, 154 F.2d 251 (5th Cir. 1946).
4. Id. at 704, 314 S.E.2d at 511.
5. 74 R.I. 344, 60 A.2d 718.
each other. The case is one of first impression in North Carolina. It sets the standard for interpreting an ambiguous dual option lease in which the relationship between the fixed price option and right of first refusal is not clearly spelled out. From a national perspective, the case adds to the body of case law stressing adherence to established rules of contract construction and interpretation.

This note will suggest that the court's decision comports with sound principles of contract and property law and the probable intention of the parties to the agreement.

THE CASE

In 1949, Texaco, Inc., the plaintiff's predecessor in interest, leased a lot on Franklin Street in Chapel Hill, North Carolina from the defendants' predecessors in interest. The lease was to run for ten years and the lessee was given the option to extend the term for four additional five-year terms. Texaco elected to extend the lease for all four extensions so the lease was due to expire on January 31, 1980. The rent for the duration of the lease, including any extensions, was set at $100 per month. The lease contained both a fixed price option for $50,000 which could be exercised at any time during the term of the lease or any extension or renewal thereof, and a clause granting an option to exercise first refusal rights. Following these two clauses was a paragraph stating:

6. 310 N.C. at 696, 314 S.E.2d at 507.
7. Id. at 697, 314 S.E.2d at 507. (11) - Option to Purchase. Lessor hereby grants to lessee the exclusive right, at lessee's option, to purchase the demised premises, free and clear of all liens and encumbrances, including leases, (which were not on the premises at the date of this lease) at any time during the term of this lease or any extension or renewal thereof, (a) for the sum of Fifty Thousand dollars; it being understood that if any part of said premises be condemned, the amount of damages awarded to or accepted by lessor as a result thereof shall be deducted from such price,
(b) On the same terms and at the same price as any bona fide offer for said premises received by lessor and which offer lessor desires to accept. Upon receipt of a bona fide offer, and each time any such offer is received, lessor (or his assigns) shall immediately notify lessee, in writing, of the full details of such offer, including the name and address of any offeror, whereupon lessee shall have thirty (30) days after receipt of such notice in which to elect to exercise lessee's prior right to purchase. No sale of or transfer of title to said premises shall be binding on lessee unless and until these requirements are fully complied with.
Any option herein granted shall be continuing and preemptive, binding on the lessor's heirs, devisees, administrators, executors, or assigns, and the failure of lessee to exercise same in any one case shall not affect lessee's right to exercise such option in other cases thereafter arising during the term of this lease or any extension or renewal thereof.  

In January 1980, the defendants received several bona fide offers from third parties for more than $50,000, the highest offer being $217,000. On January 17, Texaco gave written notice of its intention to exercise the fixed price option for $50,000, and even attempted to tender the purchase price by check on February 1. The defendant lessors, believing the contract required Texaco to meet the highest offer, refused to convey title to the property. Texaco filed suit on February 4, 1980, for specific performance of the contract. Defendants counterclaimed, asserting it had been damaged in the amount of $217,000 when the would-be purchaser withdrew his offer because of his reluctance to “buy a lawsuit.”  

At trial, both parties moved for summary judgment. The trial court denied plaintiff Texaco's motion concluding that Texaco was not entitled to specific performance. A jury trial was held on the defendants' counterclaims, and the trial court directed a verdict in favor of the plaintiff on its motion at the close of the defendants' evidence. Both sides appealed. The court of appeals reversed the trial court and entered summary judgment for Texaco and ordered specific performance of the fixed option agreement.  

The supreme court affirmed the court of appeals, holding that the properly exercised fixed price option continued to bind the defendant lessors or their successors in interest even though Texaco, the lessee, failed to meet the bona fide third-party offer.  

8. Id. at 697, 314 S.E.2d at 507.  
9. Id. at 698, 314 S.E.2d at 508. Plaintiff filed a notice of lis pendens on the property in addition to filing suit for specific performance. Defendants asserted in their counterclaim that they were entitled to treble damages because the filing of lis pendens was an unfair and deceptive trade practice. Id.  
10. Texaco, Inc. v. Creel, 57 N.C. App. 611, 292 S.E.2d 130 (1982). The North Carolina Court of Appeals held that it was bound by the general rule that a contract must be read as a whole. Individual clauses and particular words in an agreement must be considered in connection with the rest of the agreement. The court summarized the split of authority in other jurisdictions involving leases substantially similar to the one under consideration, and adopted the view that it thought was most faithful to the language of the lease, i.e., that the fixed price option and the right of first refusal operated independently of each other. Id.  
11. 310 N.C. at 704, 314 S.E.2d at 511.
BACKGROUND

The first significant case construing dual options as separate and independent is Butler v. Richardson, a 1948 case decided by the Rhode Island Supreme Court. In that case, the lessees entered into a one year lease of real estate with the lessors, owners of the real estate. The lease contained both a fixed price option for $15,000 exercisable at any time during the lease period, any extension or renewal, and a right of first refusal. The lessors received an offer from a third party, notified the lessees and requested that the lessees exercise their right to purchase per the terms of the lease. The lessees immediately notified the lessors of their intent to exercise the fixed price option for $15,000, and at the lessors' request, sent $500 to bind the deal. The lessors refused to convey the property for $15,000, and the lessees sued for specific performance of the lease. In resolving the controversy, the court was faced with the question of what effect the provision for a right of first refusal has upon the provision for a fixed price option. The court held that it had no effect whatsoever. The fixed price option remained unimpaired. The court said that the provision for a right of first refusal should be construed not so much as an alternative to the provision for an option but rather as a supplement to it—supplemental in the sense that through the right of first refusal, the lessors could induce the lessees to purchase by giving them an opportunity to purchase at a price more advantageous to the lessees than the price fixed in the option.

In Sinclair Refining Co. v. Clay, a 1951 Ohio decision, dual option provisions were included in a lease of realty for the operation of a neighborhood filling station. The lease, prepared by Sin-

12. 74 R.I. 344, 60 A.2d 718.
13. It is mutually agreed that, at any time while the Lessees are the occupants of the premises herein leased, as Lessees under this lease or any extension thereof or renewal thereof, or as tenants from month to month or otherwise, the Lessors will give them an option to buy at a price of $15,000. Or if the Lessors shall have any offer for the purchase of said premises, which the Lessors are willing to accept, the Lessors prior to accepting same, give the Lessees an opportunity to purchase the said premises on the same terms, by notifying the Lessees in writing of such offer and giving the Lessees 10 days thereafter in which the Lessees shall decide if they will purchase said premises on the same terms.

74 R.I. at 348, 60 A.2d at 720.
14. Id. at 350, 60 A.2d at 722.
clair, the lessee, was for a period of ten years and included a provision for a five year extension. In the lease, Sinclair was given a fixed price option for $8500, which could be exercised at any time during the last five years of the lease term or any extension. The lessee was also given a right of first refusal. The lessor sold the premises to a third party after Sinclair had declined to exercise its right of first refusal. Five years after the sale, Sinclair attempted to exercise the fixed price option. The lessor refused to convey, and Sinclair sued for specific performance. At trial, the lessor argued that the fixed price option was extinguished after Sinclair declined to exercise its right of first refusal. The court disagreed. It held that the two provisions were separate and distinct. The failure to exercise a right of first refusal after proper notice may well extinguish the first refusal right, but the loss of that right still leaves the fixed price option operational. The court further held that the fixed price option is a covenant which runs with the land and a grantee of the lessor is bound by the terms of the covenant. Paralleling Texaco v. Creel, even though Sinclair, the lessee, drafted the arguably ambiguous lease (as did Texaco in Creel), the court refused to construe it strictly against Sinclair.

Adams v. Willis, a 1953 South Carolina case, dealt with a dual option lease similar to the one in Sinclair Refining Co. v. Clay. The lease contained a fixed price option and a right of first refusal. The right of first refusal clause contained language to the effect that if the lessee did not elect to exercise the right of first refusal, the lessor could go ahead and sell the property subject to the lease "and to the extension and/or additional purchase options, if any, herein granted to the lessee." The lessor received a bona fide offer from a third party. The lessee chose not to exercise the first refusal rights, and the lessor sold the property to the third party. Subsequently, still during the lease period, the lessee's assignee attempted to exercise the fixed price option. The lessor's assignee refused, arguing that the refusal of the lessee to purchase the property under the right of first refusal terminated the lessee's right thereafter to exercise its purchase option.

The South Carolina Supreme Court disagreed, holding that

16. 102 F. Supp. at 733.
17. Id. at 734.
18. Id. at 734 (citing 3A THOMPSON ON REAL PROPERTY §§ 1325-30 (1959)).
20. Id. at 525, 83 S.E.2d at 174.
21. Id.
the lessee had the right to buy the property at any time during the term of the lease, at the price set in the fixed price option. In making its decision, the court stressed the language in the lease providing that any sale to a third party would be subject to the fixed price option. This language is comparable to the clause in the Creel lease which provided that "[a]ny option herein granted shall be continuing and preemptive . . . ." The argument that the Willis language is more clearly stated than the Creel language and thus the two cases are distinguishable is not persuasive. The language in Creel was construed not by laymen, but by a court proficient in discerning the meaning of less-than-clear language in a legal document.

Green v. Sprague Ranches involved an unusual situation in which the lease was modified twice—first to include a right of first refusal and then later to include a fixed price option. The lessor received a bona fide offer from a third party and notified the lessee under the terms of the right of first refusal. The lessee declined to exercise its right of first refusal. Instead, the lessee notified the lessor of its intent to exercise the fixed price option. The lessor sought declaratory relief and reformation of the lease. The trial court held for the lessor, finding that the fixed price option was extinguished by the lessee's failure to meet the terms of the third party offer. The district court of appeal reversed the trial court and ordered a new trial. Commenting that previous cases were split on what to do with these clauses, the court said each decision turns on its particular facts and contract language. The court found the intention of the parties was more reasonably interpreted as the desire to create an independent and separate right not extinguishable by the lessee's failure to exercise the right of first refusal.

The holding probably has limited utility due to the fact that the court was interpreting a lease to which a right of first refusal and a fixed price option had been added at separate times. The court did not comment on how important this fact was to their decision.

Finally, Crowley v. Texaco, Inc., a case the North Carolina
Supreme Court relied on to decide *Texaco, Inc. v. Creel*, concerned a lease agreement with purchase options similar to those found in *Creel*. The lease in *Crowley* contained a fixed price option coupled with a right of first refusal. As was the case in *Creel*, the lease further specified:

> Any option herein granted shall be continuing and preemptive binding on the lessor's heirs, devisees, administrators, executors, or assigns, and the failure of lessee to exercise same in any one case shall not affect lessee's right to exercise such option in other cases thereafter arising during the term of this lease or any extension or renewal thereof.28

During the lease term, the lessors received an offer from a third party which they desired to accept. They communicated the offer to the lessee pursuant to the right of first refusal. Through inaction, the lessee failed to exercise its right to purchase; however, several months later, the lessee notified the lessors of its intent to exercise its fixed price option. The court held that the fixed price option remained unimpaired by the lessee's failure to exercise the right of first refusal.29 Using several rules of construction,30 the court held that the "continuing and preemptive" language could not be given full effect if the lessee's failure to exercise the right of first refusal was held to terminate the fixed price option.31

The line of cases in support of the interpretation that failure to exercise the right of first refusal extinguishes the fixed price option begins with *Harding v. Gibbs*.32 In *Harding*, the parties signed a five year lease of real property. The lease contained a fixed price option which could be exercised by the lessee any time during the first year of the lease. It also gave the lessee a right of first refusal stipulating that if the lessor received an offer for the property, the lessee would be given ten days notice and the privilege of buying at such offer. If the lessee decided not to purchase, the lessor would have the privilege of selling. Within the first year of the lease, the lessor sold the property, gave the lessee notice, and the lessee

---

28. Id. at 872.
29. Id. at 874.
30. Id. at 874. The court stated that a purchase option is placed in a lease for the benefit of the lessee and is to be construed with that in mind. Also, in considering the contract, it must be construed as a whole, and the intentions of the parties is to be ascertained from the entire instrument. Id.
31. Id. at 875.
32. 125 Ill. 85, 17 N.E. 60 (1888).
made no election to purchase.33

The Illinois Supreme Court held that the lessee's failure to exercise the right of first refusal terminated the fixed price option. Therefore, the lessee could not maintain a suit for specific performance.34 The court reasoned that the lessee "could not consistently with any principle of fair and honest dealing, under the contract which he had made, destroy the opportunity of making a sale, wait until the expiration of the year to see if there might not be an increase in value of the land, and then exercise his option to purchase."35

In Manasse v. Ford,36 the California District Court of Appeal also held that failure to exercise a right of first refusal extinguished any fixed price option.37 The lessees maintained that the right to purchase under the fixed price option continued in spite of their refusal to exercise the right of first refusal. To support their argument, the lessees pointed to a proviso in the lease that said even if the lessor sold the property, the sale was subject to the lease and that the lease, its conditions, restrictions and covenants would be binding on the lessees and the purchaser.38 The court did not agree with the lessees' interpretation of this clause. It concluded that the lease gave the lessor the unqualified right to make a sale should the lessees not exercise the right of first refusal. The proviso simply meant that the lessees could not be deprived of possession during the entire term of the lease. To say that the proviso continued in force the very options that were to be extinguished by a sale would be to reason in a circle. Such was not the intention of the parties.39

In Adams v. Helburn,40 a lease contained a fixed price option coupled with a right of first refusal. The right of first refusal clause concluded with the language: "in the event that lessee fails to promptly exercise this privilege by purchase of and payment for said property, it shall not be binding."41 The court admitted that the language was not as clear as it could be, but construed it to

33. Id. at 88, 17 N.E. at 60.
34. Id. at 90, 17 N.E. at 61.
35. Id., 17 N.E. at 62.
37. Id. at 317, 208 P. at 356.
38. Id. at 314, 208 P. at 355.
39. Id. at 317, 208 P. at 356.
40. 198 Ky. 546, 249 S.W. 543 (1923).
41. Id. at 547, 249 S.W. at 543.
mean that the lessee’s failure to exercise the first refusal option extinguished the fixed price option and left the lessee with the option of purchasing “at the figure offered,” whether that be the amount set in the fixed price option or a higher amount. 42

Shell Oil Co. v. Blumberg 43 is a leading modern case in this area. Shell retained the right to purchase the leased premises at any time during the lease term for a fixed price of $10,000. Shell further retained a right of first refusal obligating the lessor to give Shell notice of any bona fide third party offers and first refusal rights to purchase on the same terms as those offered by the third party. The contract further provided that “Lessee’s failure to exercise any option herein contained shall not in any way affect this lease or the rights of Lessee in the estate hereby created.” 44 When the lessor gave notice of a bona fide offer from a third party, Shell declined to exercise its right of first refusal and specifically stated that its rejection of the offer was without prejudice to any of its other rights under the lease. 46 Three years later, still during the lease term, Shell tried to exercise its fixed price option against the purchaser. The court held that Shell’s fixed price option was extinguished by its failure to exercise the right of first refusal. 46 The court interpreted the right of first refusal clause as limiting or modifying the fixed price option. Once Shell refused to purchase on the same terms as the third party offer, the fixed price option lapsed and Shell’s remaining rights were under the right of first refusal clause. 47

Texaco, Inc. v. Rogow 48 was relied on by the lessors in Texaco, Inc. v. Creel as authority for the proposition that failure to exercise first refusal rights terminates the fixed price option. 49 In Rogow, the language in the lease was almost identical to that in Creel, with the exception of an added clause specifying that the fixed price option could not be exercised before the end of the ninth year of the ten year lease. 50 One day before the ninth year was up, the lessors notified Texaco of a bona fide offer from a third

42. Id. at 548, 249 S.W. at 543-44.
43. 154 F.2d 251 (5th Cir. 1946).
44. Id. at 252.
45. Id.
46. Id.
47. Id. at 252-53.
49. Id. at 405, 190 A.2d at 50-51.
50. Id. at 403, 190 A.2d at 50.
party which the lessors desired to accept. Several days later, after the end of the ninth year of the lease, Texaco attempted to exercise its fixed price option.\footnote{51}

Texaco based its claim to this right on a clause in the lease providing that:

[\textit{a\text{\textup{}}}}ny option herein granted shall be continuing and pre-emptive, binding on the lessor’s heirs, devisees, administrators, executors, or assigns and the failure of [Texaco] to exercise same in any one case shall not affect [Texaco’s] right to exercise such option in other cases thereafter arising during the term of this lease ...\footnote{52}

The court held that Texaco’s fixed price option could be exercised only after the first nine years of the lease term and then only before Texaco received notice from the lessors of a bona fide offer from a third party.\footnote{53} The court indicated that to hold otherwise would be to wholly subordinate the first refusal provision to the fixed price option and render inoperative the provision expressly giving the lessors the unrestricted opportunity to attempt to obtain the fair value of the property during the first nine years.\footnote{54} Accepting Texaco’s construction, the fixed price option would control the price at which the property could be sold to a third party during the first nine years of the lease even though, by the express terms of the lease, Texaco could not exercise the fixed price option until after the ninth year. Any bona fide purchaser would be obligated to convey the property to Texaco upon demand by Texaco after the nine year period at the fixed price.\footnote{55}

Professor Corbin in his treatise on contracts\footnote{56} disagrees with the result in \textit{Rogow}. He maintains that the court’s holding greatly decreases the value of the fixed price option by making it conditional on the absence of any higher offer from a third person and by making it unsafe for the lessee to make any expensive improvements on the property. Corbin concludes that if this decision were approved and followed, no lessee or other option holder should ever include in the contract a right of first refusal.\footnote{57}
Texaco, Inc. v. Creel involved the construction and interpretation of two potentially conflicting option clauses in a lease. Consider the clauses in question:

(11) - Option to Purchase. Lessor hereby grants to lessee the exclusive right, at lessee's option, to purchase the demised premises, free and clear of all liens and encumbrances, including leases, (which were not on the premises at the date of this lease) at any time during the term of this lease or any extension or renewal thereof,
(a) for the sum of Fifty Thousand dollars; it being understood that if any part of said premises be condemned, the amount of damages awarded to or accepted by lessor as a result thereof shall be deducted from such price,
(b) On the same terms and at the same price as any bona fide offer for said premises received by lessor and which offer lessor desires to accept. Upon receipt of a bona fide offer, and each time any such offer is received, lessor (or his assigns) shall immediately notify lessee, in writing, of the full details of such offer, including the name and address of any offeror, whereupon the lessee shall have thirty (30) days after receipt of such notice in which to elect to exercise lessee's prior right to purchase. No sale of or transfer of title to said premises shall be binding on lessee unless and until these requirements are fully complied with.

Any option herein granted shall be continuing and pre-emptive, binding on the lessor's heirs, devisees, administrators, executors, or assigns, and the failure of lessee to exercise same in any one case shall not affect lessee's right to exercise such option in other cases thereafter arising during the term of this lease or any extension or renewal thereof. 58

The court held that the interpretation most faithful to the language was that the fixed price option continued to bind the lessors or their successors in interest even if the lessee fails to meet a bona fide third-party offer. 59

In analyzing the court's holding, we must begin where it began—by asking: What effect did the parties intend the option clauses to have? To answer that primary question, the court examined "the language of the contract, the purposes of the contract . . . [and its] subject matter, and the situation of the parties at the

58. 310 N.C. at 697, 314 S.E.2d at 507.
59. Id. at 704, 314 S.E.2d at 511.
time the contract [was] executed." 60

A. The Language

Several rules of contract construction played important roles in the court's consideration of the contract language. One such rule is that a contract is to be construed as a whole. Each clause must be considered with reference to the other provisions and be given effect, if possible, by any reasonable construction. 61 The court approved of the South Dakota Supreme Court's statement in Crowley v. Texaco, Inc. 62 that "[e]very effort should be made to give effect to every part of the contract and the interpretation should not be such as to excise any provisions." 63 This concern was clearly important to the court.

The North Carolina Supreme Court refused to follow the lead of Texaco, Inc. v. Rogow 64 which interpreted substantially similar language as rendering the fixed price option ineffective once the lessee failed to exercise the right of first refusal. The Creel court indicated that to so hold would be to give no effect to the "continuing and preemptive" language following the right of first refusal option. 65 The court may also have chosen not to follow Rogow because the court recognized the wisdom in the Rogow court's proclamation that "[s]ince such contracts, although often generally similar, are worded differently and executed under varying circumstances, a decision interpreting and construing one contract is far from controlling in a case involving another." 66

In following Crowley v. Texaco, Inc., 67 the court gave at least tacit approval to a second rule of contract construction enunciated by the Crowley court: A purchase option is for the benefit of the lessee and is to be construed with that in mind. 68 Counsel for the lessors argued in their brief that this rule is not law in North Caro-

60. Id. at 699-700, 314 S.E.2d at 508.
63. 310 N.C. at 703, 314 S.E.2d at 510 quoting Crowley, 306 N.W.2d 871, 874.
64. 150 Conn. 401, 190 A.2d 48 (1963).
65. 310 N.C. at 704, 314 S.E.2d at 509-10.
66. 150 Conn. at 406, 190 A.2d at 51.
67. 306 N.W.2d 871.
68. 310 N.C. at 703, 314 S.E.2d at 510, quoting Crowley, 306 N.W.2d 871, 874.
lina. Counsel pointed to the established rule which requires that an ambiguity in a written contract be construed against the party who prepared the writing. Since Texaco drafted the lease, any ambiguity in the option provisions should be construed against it. Counsel for the lessors failed to point out that this rule cannot have the effect of modifying the plain provisions of the written instrument when it is signed by the other party and there is no evidence of fraud or misrepresentation. The court apparently accepted the option clauses as "plain provisions" rather than ambiguities.

B. The Purposes

An examination of the general purposes of the dual option provisions points the way to an understanding of the proper interplay of the two option provisions. The Blumberg and Rogow courts interpreted the right of first refusal option as limiting or modifying the fixed price option. The Rogow court reasoned that if the lessee were allowed to exercise the fixed price option after it had declined to meet a third party offer, the lessee could effectively control the price at which a third party would offer to buy the property during the entire term of the lease.

The Creel court was clearly dissatisfied with the reasoning in Rogow. Without explicitly saying so, the court may have accepted Professor Corbin's view that "[t]hat is exactly the purpose for which the option was purchased and paid for. That factor largely determined the amount of the rental paid to the lessor. It is that factor that gave security to the lessee in erecting buildings and making permanent improvements." The court recognized that Texaco had a commercially justifiable interest in protecting its substantial investment in permanent improvements to the land in

72. Merchants Oil Co. v. Mecklenburg County, 212 N.C. 642, 194 S.E. 114 (1937).
73. 154 F.2d 251.
74. 150 Conn. 401, 190 A.2d 48.
75. Id. at 407, 190 A.2d at 51.
76. Corbin, supra note 56, at § 261B.
the form of filling station facilities. Without the right to purchase the property at the fixed price throughout the lease-term, Texaco would be in the position of having to meet any bona fide offer from a third party or risk losing its investment. Also, without the fixed option right, Texaco would be in an inferior bargaining position when renegotiating the lease. It would have to pay whatever the lessors demanded or lose its investment. These factors clearly influenced the court to reject the Rogow court’s interpretation.

The court still had to determine what effect, if any, the first refusal provision had on the fixed price option. The court accepted the view adhered to in Butler v. Richardson, a leading case in this area. Addressing the first refusal provision, the Butler court said, “the question here is what effect this provision for a first refusal has, if any, upon the provision for an option. As we indicated above it has no effect whatever. The right of option remains unimpaired.”

The Butler court also addressed what purpose the right of first refusal provision could have in light of its interpretation of the relationship between the two provisions: “[T]he provision for a first refusal may nevertheless serve a useful purpose. It provides a means whereby [lessors], if they desired, could induce an acceleration of [lessees’] decision to purchase by affording them an opportunity to purchase at a price more advantageous to them than the price fixed in the option.” For example, the lessors may receive a third party offer for less than the price set in the fixed price option. For whatever reason, the lessors may desire to accept this offer. By communicating this offer to the lessee in accordance with the right of first refusal, the lessors may induce the lessee to purchase immediately rather than carry on with the lease agreement.

The Creel court considered this purpose to be a motivating factor in the lessors’ decision to enter into this lease. The court said, “[t]he lessors were most likely concerned about being in a position to induce lessee to buy the property at a price more advantageous than the fixed price option, should they no longer wish to have their asset tied up in a long-term lease.” Thus, the court

77. 310 N.C. at 704-05, 314 S.E.2d at 511.
78. 74 R.I. 344, 60 A.2d 718 (1948).
79. Id. at 349, 60 A.2d at 722.
80. Id. at 349-50, 60 A.2d at 722.
81. 310 N.C. at 705, 314 S.E.2d at 511.
found their interpretation of the dual options served the purposes of both the lessors, Creel, and the lessee, Texaco. With the fixed price option exercisable at any time during the term of the lease, Texaco enhanced its investment in permanent improvements by protecting against a sharply rising local real estate market and prohibitive rental rates when renegotiating the lease. The lessors, by way of the right of first refusal provision, had a way to accelerate the lessee’s exercise of the fixed price option should the lessors no longer want to keep the property. On the other hand, the Rogow court’s interpretation of the right of first refusal as a limitation on the fixed price option would completely frustrate Texaco’s commonsense desire to protect its substantial investment by rendering the fixed price option ineffectual.

The interpretation arrived at by the court through analyzing the purpose of the provisions clearly comports with sound principles of contract and property law. Professor Corbin, in his treatise on contracts, discusses the exact situation being considered here. He states: “A party may acquire a Power of Acceptance at one price and at the same time a Right of First Refusal at another price, with respect to the very same subject matter. There is no inconsistency between these two provisions.” Professor Corbin goes on to explain that the fixed price option is an irrevocable offer creating in the offeree a power of acceptance conditioned only upon the offeree’s own voluntary act of acceptance. Conversely, the right of first refusal is not an offer at all, but a promise creating in the offeree a right to be given the first offer.

Professor Corbin discusses a situation on point with Creel: the situation in which the offeror (lessor) receives, and desires to accept, an offer from a third party that is higher than the fixed price option. He states that the offeror (lessor) cannot be rid of his duty to the offeree (lessee) not to sell simply by notifying the offeree (lessee) of the third party’s offer and his desire to accept it. Such notice would empower the offeree (lessee) to accept at the higher price, but a sufficient reason not to is that he still has the power of accepting the lessor’s previous irrevocable offer for the remainder
of the option period.\textsuperscript{88}

Under principles of property law, there is nothing incongruous about the fixed price option binding third party purchasers of the property as long as the option is exercised within the option period. The option is part of a recorded instrument that imposes a burden on realty. The obligations of the option are not personal but amount to covenants running with the land.\textsuperscript{89}

C. The Situation of the Parties

The court restated a fundamental rule of construction when it said, "in construing a contract we look . . . at the situation of the parties at the time the contract was made."\textsuperscript{90} Contracts are viewed prospectively from the time they were made and the intentions of the parties at that time are controlling. The court believed that the situation of the parties in 1949, when the lease was made, indicated they intended both options to continue even if a third party offer was not met by the lessee.\textsuperscript{91} In support of that belief, the court pointed to the disparity in local property values today as compared to 1949. The court concluded that in 1949 "[it] was unlikely that either party anticipated the dramatic increases in property values on Franklin Street in Chapel Hill which have occurred in the intervening years."\textsuperscript{92}

The lessors argued that to construe the fixed price option as enforceable against them and all third parties who purchased the property from them, in spite of the fact that the lessee failed to exercise its right of first refusal, would be to place a ceiling on the amount that the property could be sold for during the entire thirty years of the lease and its renewals. Such a construction of the dual options would deprive the lessors of all appreciation in value.\textsuperscript{93} The court recognized the harsh effect of their interpretation,\textsuperscript{94} but correctly observed a rule of construction dictating that the courts may not grant relief merely because the contract is a harsh one.\textsuperscript{95} The

\begin{itemize}
\item \textsuperscript{88} Id. at 494.
\item \textsuperscript{89} First-Citizens Bank \& Trust Co. v. Frazelle, 226 N.C. 724, 40 S.E.2d 367 (1946), citing Crotts v. Thomas, 226 N.C. 385, 387, 38 S.E.2d 158, 159 (1946).
\item \textsuperscript{90} 310 N.C. at 704, 314 S.E.2d at 511.
\item \textsuperscript{91} Id.
\item \textsuperscript{92} Id.
\item \textsuperscript{93} Defendant-Appellees' Brief at 8, Texaco, Inc. v. Creel, 310 N.C. 695, 314 S.E.2d 506 (1984).
\item \textsuperscript{94} 310 N.C. at 704, 314 S.E.2d at 511.
\item \textsuperscript{95} Weyerhauser Co. v. Carolina Power \& Light Co., 257 N.C. 717, 127 S.E.2d
\end{itemize}
courts cannot make better, or more equitable agreements for the parties than they themselves had been satisfied to make. Further, the court cannot rewrite contracts because they operate harshly or inequitably as to one of the parties or, by construction, relieve one of the parties of terms to which it voluntarily consented.96

The court also pointed out that the amount set in the fixed price option was a bargained-for sum. The court reviewed Rogow97 and Crowley,98 two other cases in which Texaco was both the drafter of the lease and lessee, and concluded that Texaco did not have a uniform price it insisted upon in the fixed price option. The rent was only $100 per month for the entire term of the lease. Given this fact, the court considered it probable that the lessors viewed the $50,000 fixed price option as being reasonable, even at the end of the lease term.99

**CRITICISM**

From the foregoing analysis, it cannot be seriously argued that the court made an incorrect decision, at least from the standpoint of established rules of contract construction. But there is room for argument that the lessors' interpretation is just as tenable as the court's interpretation for somewhat different reasons. The court's primary purpose was to give effect to the intentions of the parties as expressed by the language used in the contract. Can it be believed that if someone had told the lessors in 1949 that they could not sell their property for more than $50,000 at any time during the thirty year period of the lease, even if someone offered them substantially more, they would have agreed to it? The court attempted to answer this question by saying that it was probable that the lessors viewed the $50,000 fixed price option as being reasonable even at the end of the lease term,100 but the court's conclusion is speculative at best.

The court accepted the view that the right of first refusal provided a means whereby the lessors, if they wished, could accelerate Texaco's decision to purchase by giving it an opportunity to buy the property at a better price than that fixed in the option. The

539 (1962).
96. 17 AM. JUR. 2D Contracts § 242 (1979).
97. 150 Conn. 401, 190 A.2d 48.
98. 306 N.W.2d 871.
99. 310 N.C. at 705, 314 S.E.2d at 511.
100. Id.
court considered this a motivating factor in the lessors' decision to enter into the lease. The right of first refusal as the lessors interpreted it probably was a motivating factor. But as the court interpreted it, the acceleration would only occur at a price under that fixed in the option. It is difficult to see how such a dubious benefit could have been a motivating factor for the lessors.

Further, can it be believed that the $50,000 fixed price option was really a bargained-for sum as the court concluded? In spite of the fact that Rogow and Crowley demonstrate that even though the lease agreement was a standard-form contract and there was no uniform price that Texaco insisted upon in the fixed price option, one may question whether the individual lessors and Texaco, an industrial giant, could ever have bargained on equal footing.

Texaco drafted this lease. Should the lease not have been construed against Texaco as the lessors suggested? To do so, the court would have had to modify what it considered to be "the plain provisions" of the written agreement—something the court was clearly unwilling to do. But had the "plain provisions" been considered "ambiguities" by the court, there may have been a different result. There is no question that these "plain provisions" are capable of two distinctly different interpretations. This is evidenced by the conflicting case law from around the country. Texaco, a huge corporate lessee, drafted this lease. Why shouldn't they be penalized for not drafting the lease in clear, precise terms that explain how the fixed price option and right of first refusal work and relate to each other?

Further, as the lessors also suggested, why shouldn't the court have construed the fixed price option strictly in favor of the optionor given the unilateral nature of the option and its effect of restraining alienation? The answer may have to do with the purpose of an option. It is for the benefit of the optionee (lessee). The court accepted the principle that the option should be construed with that in mind.

As can be seen, there are some valid questions that the court could have answered differently given a slightly different set of facts. Contracts, although often similar in effect, are worded differ-

101. Id.
103. Id.
104. 310 N.C. at 703-04, 314 S.E.2d at 510-11.
ently and created under varying circumstances. Thus, a decision interpreting one is far from controlling in a case involving another. This case cannot not be relied on as a substitute for a precisely drafted contract.

CONCLUSION

The court held that Texaco's election not to exercise its contractual right of first refusal did not terminate, or in any way impair its rights under the fixed price option especially where contract language specifically called for the option, rights to continue in the lessee even in the event of such refusal. This result recognizes that the fixed price option and the right of first refusal provision are intended to operate separately, and that to interpret the latter as limiting the former deprives the lessee of the protection it sought for its substantial investment in improvements and potentially emasculates the fixed price option. The result recognizes that an option, by its very nature, is an irrevocable offer, bought and paid for, which is conditioned only upon the lessee's acceptance, not the mere notice of a third party offer.

The court's decision is sound but not without its troubling questions: Were the intentions of the parties really given effect? Why shouldn't Texaco, the drafter, bear any unpleasant consequences of its poorly drafted lease? Troubling though they may be, they do not override the fundamentally correct application of the law to the facts of this case.

Mark Scruggs

105. 150 Conn. at 406, 190 A.2d at 51.