Rights of pre-emption and rights of refusal can be used in corporate and commercial contracts to give one party (preferred party) rights to buy or sell just about anything from the party granting the rights (grantor). In shareholders agreements for example, they are often used in favour of shareholders where one shareholder proposes to transfer its shares.

There is a danger in overlooking the exact nature of these kinds of rights. Subtle differences in approach can materially impact on the way in which the grantor is able to deal with an underlying asset or more generally conduct its business.

Taking the example of a shareholder intending to sell shares, pre-emption rights can be viewed as falling within one of the following three categories:

- a right of first look, giving the preferred party the opportunity to offer terms, including as to the purchase price to buy the seller’s shares. If the seller rejects that offer, it will not be permitted to sell those shares to a third party at a price less than the offer price or on other terms more favourable to the third party than the terms of the rejected offer;
- a right of first refusal, being similar to a right of first look, except that the preferred party has the opportunity to accept or reject terms offered by the seller for the sale of the shares, rather than the opportunity to offer terms to the seller; and
- a right of last refusal, giving the preferred party the opportunity to accept or reject terms conditionally agreed between the seller and a third party for the sale of the shares.

If the process is properly documented, specified time periods will be applicable to each step. For example if the parties do not agree a share sale pursuant to the pre-emption right, there is usually a subsequent time period in which the seller may sell the shares to a third party, failing which it must again comply with the pre-emption process in order to transfer its shares. In addition, the process may provide for a formula or mechanism to appoint an independent person to value the shares.

A right of first look is the most favourable to the grantor, as it does not have to show its hand, letting the preferred party make the first move instead. A right of last refusal is the most favourable to the preferred party, as the grantor must not only test the market, but must bring to the preferred party a negotiated deal. However, as a practical matter, a third party may be deterred by a right of last refusal, knowing that the time it invests in assessing the opportunity to make an offer will only result in its offer price being ‘shopped’ back to the preferred party. Moreover, the preferred party usually has a specified time period to consider the third party offer, time that may seem to the third party like unnecessary delay. If the terms of the contract containing the pre-emption right are confidential, the grantor will find it difficult to explain to the preferred party the reason for the delay. If the pre-emption right is wide reaching in the context of the grantor’s business, for example it relates to major supply items, it may impact the grantor’s ability to engage with its marketplace and remain competitive.

As suggested above, price is often one of many considerations in commerce, and the offer terms of pre-emption rights will often contemplate other factors relevant to the underlying goods or services, such as quality, delivery times, technical specifications, payment terms and counterparty credit risk. In this case, the offer against which the pre-emption right operates can be the terms of the offer viewed as a whole, or some balanced score of those terms. This can introduce a degree of judgment, giving the grantor scope to justify rejecting the preferred party in order to deal with a third party.

Nevertheless, grantors should be aware that the pre-emption process itself may mean that in reality the preferred party is the only game in town.