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Fixed Price Preemptive Rights in California: The Quality of Mercer is Strained

By Phil Miller*

The right of alienation is an inherent and inseparable quality of an estate in fee simple. . . . Therefore, any and all restraints . . . necessarily must be repugnant to and inconsistent with the grant, and, as such, void.¹

A preemptive right . . . merely requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the preemptive right at the stipulated price and is valid.²

The above quotations indicate more than a simple difference of opinion between Divisions Two and Four of California’s Second Appellate District. They indicate a deeply rooted conflict in California property law. The conflict can be phrased in several ways. In its broadest form, the conflict concerns the validity of restraints on alienation—limitations on the ability to convey an interest in one’s property, however, whenever, and to whomever one chooses, at whatever price one’s business judgment or whimsy dictates. More precisely, the conflict concerns the validity of a particular type of restraint on alienation—the right of first refusal, or preemptive right.³

As its name implies, a preemptive right obligates the owner of property, when and if he or she decides to sell the property, to offer it first to the holder of the preemptive right. If the holder (or preemptioner) elects not to exercise the right to buy, the owner has fulfilled his or her obligation and is free to sell the property to any third party.⁴

Unlike an option contract, the holder of a preemptive right has no

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³ Preemptive rights have been known through the years by many different names, including right of first refusal, first opportunity to purchase, first right to purchase, first privilege to purchase, refusal of purchase, and double option. See Schwartz v. Shapiro, 229 Cal. App. 2d 238, 255, 40 Cal. Rptr. 189, 201 (1964).
⁴ Preemptive rights also may arise in lease transactions, i.e., the lessee may hold a preemptive right to renew the lease should the lessor choose to lease the property again at
power to compel an unwilling landowner to sell; the preemptive right arises only when the owner elects to sell the property.  

The price term of a preemptive right provision generally takes one of two forms: the preemptioner has the right to purchase property either at a price equal to the best offer received from a third party or at a fixed price stated in the agreement creating the right. In light of the tendency of real property values to increase over time, a fixed price preemptive right imposes a substantially greater restraint on alienation than a “best offer” preemptive right. If the value of the property has increased significantly over time, an owner who is bound by a fixed price term is forced either to retain the land or to sell it at a substantial sacrifice. This danger that fixed price preemptive agreements will hinder transfers of interests in real property is the heart of the conflict in California.

Despite this potential restraint on alienation, the California Court of Appeal twice has explicitly upheld fixed price preemptive agreements. These decisions are not totally persuasive, however, for two reasons. First, the cases provide little more than a superficial analysis of the danger to real property interests posed by such provisions. Second, the cases appear to be in sharp opposition to recent California case law concerning other types of restraints on alienation. Contributing to this uncertainty is a single California Supreme Court decision in which the court, apparently in dicta, declared that fixed price pre-

Because the above examples are really only variations on the basic price standards discussed in the text, this Article treats all preemptive rights as either “best offer” or “fixed price” preemptive rights.


9. Restraints on alienation are condemned by CAL. CIV. CODE § 711 (West 1954), which states: “Conditions restraining alienation, when repugnant to the interest created, are void.”

10. See text accompanying notes 36-45 infra.
emptive rights are void.\textsuperscript{11}

As a result of this conflicting decisional law, the validity of fixed price preemptive rights in California remains unclear. This Article explores the conflict in California concerning the validity of fixed price preemptive rights as they apply to the disposition of real property. The Article first discusses the California decisions upholding fixed price preemptive rights and then examines a line of California Supreme Court decisions that promote policies inconsistent with the decisions upholding such rights. After considering the conflict in California, the Article examines the attitudes that other states have taken toward fixed price preemptive provisions. In conclusion, the Article proposes a test of the validity of such provisions which provides a solution to the conflict.

The Basis for the Conflict in California

Cases Upholding Fixed Price Preemptive Provisions

There are two cases in California that explicitly uphold preemptive rights at fixed prices. In \textit{Schwartz v. Shapiro},\textsuperscript{12} the plaintiff and defendants entered into a contract for the joint purchase of an apartment building. The parties also entered into a second agreement which provided that, should either party decide to sell its one-half interest, that party first must offer it to the remaining owner at the selling party's share of the original purchase price. Some time thereafter, a dispute arose between the parties and plaintiff filed an action for partition. Defendants claimed in response that they were entitled to purchase plaintiff's one-half interest in the apartment. Plaintiff made two assertions in defense to this claim. First, plaintiff argued that the application for partition was not equivalent to a sale of the property and thus the preemptive right was inapplicable. Second, plaintiff claimed that if the action for partition was deemed to be a sale, the preemptive right was invalid as against public policy.

Although the trial court ruled that the action for partition was not equivalent to a sale, the court of appeal reversed, concluding that the right of partition could be enforced only after defendants were offered the opportunity to exercise their preemptive right.\textsuperscript{13}

The decision in \textit{Schwartz} appeared to turn on two points. As the first basis of its decision, the court evaluated the fairness of the price set

\textsuperscript{11} Maynard v. Polhemus, 74 Cal. 141, 15 P. 451 (1887).
\textsuperscript{12} 229 Cal. App. 2d 238, 40 Cal. Rptr. 189 (1964).
\textsuperscript{13} \textit{Id.} at 253, 40 Cal. Rptr. at 199.
in the preemptive agreement by considering the fairness of the negotiations and the value of the property at the time of contracting.\textsuperscript{14} By taking this approach, the court failed to recognize that the danger to real property transactions inherent in fixed price preemptive rights is that the property will increase in value after the agreement is entered into, thereby creating a substantial restraint on alienation. Indeed, in addressing the fairness and reasonableness of the price term, the court failed even to mention the potential restraint on alienation created by the fixed price preemptive agreement.

The court's failure to acknowledge this potential restraint is further reflected in the second basis of the \textit{Schwartz} decision. The court relied on previous decisions in California upholding preemptive agreements.\textsuperscript{15} Analysis of the cases referred to by the court reveals, however, that the court's reliance was misplaced. Of the six California cases cited by the court as upholding preemptive agreements,\textsuperscript{16} only one, \textit{Falkenstein v. Popper},\textsuperscript{17} involved a fixed price element, and this case

\begin{itemize}
  \item \textsuperscript{14} The court stated: "The basis of the trial court's conclusion that the contract is unfair and inequitable, while not entirely clear, appears to be grounded on the fact that the property was purchased for $143,000 but was worth $200,000 at the time of trial. The fairness and reasonableness of the contract to convey must, however, be determined from conditions existing at the time it was made. A subsequent increase in value is immaterial as respects specific performance. . . . Agreements in the nature of the writing under scrutiny are not against public policy. . . . Accordingly, agreements whereby a party is given the 'first opportunity' or the 'first right' or the 'first privilege' or the 'first refusal' to purchase property or to renew a lease have been upheld in this state." \textit{Id.} at 255, 40 Cal. Rptr. at 200-01. The court went on to note: "We are not unmindful that under certain circumstances the enforcement of an agreement such as the one in the instant case would be inequitable. However, such agreements are not unfair or unconscionable per se. . . . There was no showing that the price of $143,000 originally paid by the parties was inadequate. To the contrary, the evidence discloses, and it is not disputed, that such price was a fair market value reached after extensive negotiations with the previous owner. It was error, therefore, to hold that the subject preemption agreement was inequitable." \textit{Id.} at 256-57, 40 Cal. Rptr. at 201.
  \item \textsuperscript{15} \textit{Id.} at 255, 40 Cal. Rptr. at 201.
  \item \textsuperscript{17} 81 Cal. App. 2d 131, 183 P.2d 707 (1947).
\end{itemize}
was decided on a different issue. In *Falkenstein*, the defendant-lessee gave the plaintiff-lessee an absolute two-year option to purchase the leased property for a stated price. For three years after the option had lapsed, plaintiff was given the "first opportunity to purchase said property for said price." Some four years after entering into this agreement, plaintiff attempted to exercise an absolute option to purchase the property. When defendant refused, plaintiff sued for specific performance. Judgment was entered for defendant on the pleadings.

On appeal, the issue was not the validity of the fixed price element of the agreement, but whether the language "first opportunity to purchase" gave plaintiff an absolute option to force sale of the property or merely a right of first refusal should defendant elect to sell. In confirming the judgment below, the court concluded that although plaintiff held an absolute option for the first two years of the agreement, at the time plaintiff sought the conveyance of the property, he held only a preemptive right. The *Falkenstein* court never reached the issue of the fixed price element. Thus, the cases cited in *Schwartz*, while supporting the validity of "best offer" preemptive rights, do not provide direct authority for upholding a fixed price preemptive right.

The second California case upholding a fixed price preemptive right is *Mercer v. Lemmens*. In *Mercer*, plaintiff purchased a parcel of land from defendant and obtained a preemptive right on an adjoining parcel of land at the fixed price of $10,000. When, six years later, defendant contracted to sell the property in question to a third party for $22,000, plaintiff attempted to assert his preemptive right to purchase the lot for $10,000. Defendant refused to honor the right, and plaintiff brought suit.

The trial court entered judgment for plaintiff in the sum of $12,000, the difference between the property's fair market value and plaintiff's preemptive right price of $10,000. In affirming the trial court's decision, the court of appeal paid virtually no attention to the fixed price element of the agreement. Instead, it focused almost entirely on the distinction between absolute options and true preemptive

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18. *Id.* at 132, 183 P.2d at 707.
19. *Id.* at 133, 183 P.2d at 708.
21. The court in *Mercer*, as the court in *Schwartz*, addressed the reasonableness of the fixed price term merely by stating that "simply because the property increased substantially
The court cited no California decisions as authority for its unconditional validation of fixed price preemptive agreements. Nor did it offer any further explanation or justification for upholding fixed price preemptive rights in light of their potential restraint on alienation. Indeed, the decision appears to assume that the validity of fixed price preemptive rights was settled beyond the need for discussion.

Notwithstanding the failure of the *Schwartz* and *Mercer* courts to identify and discuss the dangers presented by fixed price preemptive agreements, the decisions, standing alone, appear to validate such agreements in California without regard to the quantum of restraint on alienation that might result from a subsequent increase in the value of the subject property.

There exists, however, another line of cases in California which promotes policies in direct conflict with the holdings in both *Schwartz* and *Mercer*.23 Interestingly, none of the cases in either line of decisions even acknowledges that a divergence of opinion exists. The matter is further complicated by the fact that several important cases in this second line deal not with fixed price preemptive rights, but rather with a somewhat different type of restraint on alienation, due-on-sale and due-on-encumbrance clauses.24 Nevertheless, as will be seen, several decisions by the California Supreme Court imply that both fixed price preemptive rights and due-on clauses are but different manifestations of the same evil—restraints on alienation.

in value in the meantime the exercise of the preemptive right is not rendered unreasonable.” *Id.* at 172, 40 Cal. Rptr. at 806.

22. Indeed, the mere mention of the fixed price element seemed almost chance: “The distinction between an option and a preemptive right is well-recognized in the law. A preemptive right does not give the preemptioner the power to compel an unwilling owner to sell; it merely requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the preemptive right at the stipulated price and is valid.” *Id.* at 170, 40 Cal. Rptr. at 805.

23. See notes 25-45 & accompanying text *infra*.

24. Due-on-sale clauses are typically found in financing agreements. For example, a bank might make a loan for the purchase of a home contingent upon the continued ownership of the home by the original borrowers. If the original borrowers convey the home before the full amount of the loan is repaid, the bank can accelerate all future mortgage payments. The balance of the loan thus is “due-on” the sale of the home by the original borrowers. This is one method by which a bank can protect itself from having an outstanding loan assumed by persons with unacceptable credit status. Due-on-encumbrance clauses allow acceleration of outstanding indebtedness upon the mere encumbrance of security property. Like fixed price preemptive rights, due-on clauses act as restraints on the ability to freely alienate property; acceleration of the unpaid balance of a home loan creates a substantial risk of foreclosure—a clear disincentive to alienation. For a discussion of the due-on clause under California law see Note, *Wellenkamp v. Bank of America: A Victory for the Consumer?*, 31 Hastings L.J. 275 (1979).
Cases Tending to Negate the Validity of Fixed Price Preemptive Provisions

Until 1964, a consistent line of California Supreme Court decisions had interpreted section 711 of the California Civil Code\(^\text{25}\) to require an absolute ban on all restraints on alienation. These cases dealt with both preemptive and nonpreemptive agreements that posed restraints on alienation.

In the 1883 decision in *Murray v. Green*,\(^\text{26}\) the supreme court invalidated a provision of a deed in fee simple which prohibited sale of the subject property by the grantee without the written consent of a named third party. Citing section 711, the court held the provision to constitute an invalid restraint on alienation.\(^\text{27}\) Rejecting the argument that the restraint was only a partial restraint and therefore valid, the court queried: "[I]s it not obvious in case of a grant in fee simple, where there is no possibility of reverter, any restraint whatever on the power of alienation would be repugnant to the interests created by the grant?"\(^\text{28}\)

In *Maynard v. Polhemus*,\(^\text{29}\) the supreme court invalidated a clause in a deed providing that if the grantee ever desired to sell the property, the grantee should offer it to the original grantor at the grantee's purchase price. Unfortunately, the opinion does not make clear whether the court invalidated the clause on the ground that it was a condition creating a fixed price preemptive right or on the ground that, as a purely personal covenant, the benefit legitimately could not run to the grantor's heirs. Nevertheless, the court did note that should the clause be "regarded as a condition, it is unreasonable, and contrary to the policy of the law, because in restraint of alienation."\(^\text{30}\) Although this statement very well may be dicta, it serves to show that the court considered fixed price preemptive rights to be void.

The rule laid down in *Murray* was adhered to\(^\text{31}\) until 1964, when the California Supreme Court decided *Coast Bank v. Minderhout*.\(^\text{32}\) In that case, plaintiff-bank made several loans to Burton and Donald En-

\(^{25}\) CAL. CIV. CODE § 711 (West 1954) states: "Conditions restraining alienation, when repugnant to the interest created, are void."

\(^{26}\) 64 Cal. 363, 28 P. 118 (1883).

\(^{27}\) Id. at 366, 28 P. at 120.

\(^{28}\) Id. at 367, 28 P. at 120 (emphasis added).

\(^{29}\) 74 Cal. 141, 15 P. 451 (1887).

\(^{30}\) Id. at 143, 15 P. at 452 (citing Murray v. Green, 64 Cal. 363, 28 P. 118 (1883), and § 711).


\(^{32}\) 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).
right, both of whom executed a promissory note for the amount of the indebtedness and secured the loan with real property. In a separate instrument signed shortly thereafter, plaintiff and the Enrights executed an agreement concerning the property containing a standard due-on-sale clause.\textsuperscript{33}

One year later, the Enrights conveyed the subject property to defendants. Plaintiff elected to accelerate the amount of unpaid indebtedness, but being unable to collect the unpaid balance, brought an action to foreclose its alleged equitable mortgage on the subject property. Defendants objected that the due-on-sale clause represented an invalid restraint on alienation.

A unanimous court held that an absolute ban on restraints on alienation was no longer necessary in California, as "the rule . . . needlessly invalidates reasonable restraints designed to protect justifiable interests of the parties."\textsuperscript{34} The court concluded that the bank's interest in conditioning its extension of credit to the Enrights upon their retaining an interest in the property securing the debt was justified and validated the restraint on alienation inherent in the due-on-sale clause.\textsuperscript{35}

In two cases following \textit{Minderhout}, however, the California Supreme Court made it clear that the rather sharp break with tradition announced in \textit{Minderhout} was to be strictly construed. In \textit{La Sala v. American Savings and Loan Association},\textsuperscript{36} plaintiffs Frank and Grace La Sala borrowed money from defendant American to purchase certain property, giving American a deed of trust containing a standard due-on-encumbrance clause. Seven years later, the La Salas borrowed money from a third party, giving that party a second deed of trust on the subject property. Upon learning of this, American reminded the La Salas of its right to accelerate the debt, but offered to waive the right in}

\textsuperscript{33} For a brief definition of due-on clauses see note 24 \textit{supra}.
\textsuperscript{34} 61 Cal. 2d at 316, 392 P.2d at 268, 38 Cal. Rptr. at 508. The court went on to note that California law already had recognized several interests which justified reasonable restraints on alienation: spendthrift trusts (because of the settlor's interest in protecting potentially improvident beneficiaries); a lease for a term of years (because of the lessor's interest in the personal character of the lessee); a life estate (because of the interest of the remainderman in the life tenant's character); the transfer of certain corporate stock (because of the interest of shareholders in the persons with whom they are in business); and executory land contracts (because of the vendor's interest in the upkeep of the property and in the character and integrity of the purchaser).

Of equal interest, the court in \textit{Minderhout} did not note the line of cases soon to be relied upon in \textit{Schwartz} as validating "best offer" preemptive rights.
\textsuperscript{35} \textit{Id.} at 317, 392 P.2d at 268, 38 Cal. Rptr. at 508.
\textsuperscript{36} 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).
return for payment of $150 and an increase in the rate of interest on the first deed of trust. The La Salas, together with another person experiencing a nearly identical problem, filed a class action seeking, *inter alia,* to have the due-on-encumbrance clause declared void. When American offered to waive the clause as to the named plaintiffs, the trial court dismissed the action without notice to the class.

After ruling that the trial court had erred in dismissing the action without notice to the class, the California Supreme Court addressed American's contention that the due-on-encumbrance clause was valid as a matter of law. The court, while reaffirming the holding in *Minderhout* that the *sale* of security property may justify a restraint on alienation, concluded that the mere *encumbrance* of security property provides much less justification for imposing restraints. In reaching its conclusion, the court reasoned that the salient feature distinguishing due-on-sale from due-on-encumbrance clauses was the likelihood of risk to the lender's security.\(^{37}\) The court found that the risk to the lender that would arise from the mere encumbrance of security property would justify a restraint on alienation only when the restraint was "reasonably necessary to avert danger to the lender's security."\(^{38}\)

The rule announced in *Minderhout* was limited further in *Tucker v. Lassen Savings and Loan Association.*\(^{39}\) In *Tucker,* plaintiffs purchased land financed by defendant Lassen, giving Lassen a deed of trust containing a due-on-sale clause. Plaintiffs subsequently entered into an installment land contract with a third party, under which plaintiffs were to retain title to the property until the full purchase price had been paid. Upon learning of the contract, Lassen sought to enforce the due-on-clause and, when plaintiffs failed to pay, filed a notice of default. Lassen and the third party subsequently entered into an agreement whereby the third party purchaser assumed the existing loan at an increased interest rate. The plaintiffs sued Lassen for loss of anticipated profits on the installment land contract, contending that the due-on-sale clause was an unreasonable restraint on alienation.

The trial court held for the plaintiffs, concluding that the installment land contract in no way impaired the defendant's security interest in the land and that Lassen's enforcement of the due-on-sale clause was therefore unreasonable. In affirming the ruling below, the California Supreme Court first noted that the *Minderhout* decision validated due-on-sale clauses only when they were reasonably necessary to protect a
lender's security interest. After recognizing the limits of the Minderhout holding, the court formally adopted a two prong test to be used in determining the reasonableness of due-on clauses. Under this new test, the reasonableness of a due-on clause was to be judged by balancing the justification for the restraint against the quantum of the restraint resulting from the clause. In explaining the test, the court stated that "[t]o the degree that enforcement of the clause would result in an increased quantum of actual restraint on alienation in the particular case, a greater justification for such enforcement from the standpoint of the lender's legitimate interests will be required in order to warrant enforcement." Applying the test to the facts before it, the court concluded that, for installment land contracts in which the original borrower retains an interest in the property which provides a considerable incentive to maintain the property, a due-on-sale clause will be enforced only if the lender can demonstrate a threat to its interest sufficient to justify the restraint. As in La Sala, the court in Tucker, while not directly overruling Minderhout, cast serious doubt on its continued viability.

Finally, in Wellenkamp v. Bank of America the California Supreme Court specifically overruled Minderhout. In Wellenkamp, the plaintiff, who had purchased a parcel of residential real property, sought an injunction against the defendant bank's enforcement of a due-on-sale clause contained in a deed of trust given as security by the seller of the property. In concluding that the per se reasonableness of due-on-sale clauses announced in Minderhout allowed too great a restraint on alienation, the court pointed out that although circumstances might arise that would justify the lender's enforcement of a due-on clause in the event of an outright sale, "the mere fact of sale is not in itself sufficient to warrant enforcement of the clause, and the restraint on alienation resulting therefrom . . . ."

With the decision in Wellenkamp, the California Supreme Court seems to have come nearly full circle, moving from the absolute ban on restraints announced in Murray to the liberalization in Minderhout, and back to the very strict justification required in Wellenkamp. But the path of logic followed by the court leads to a dilemma: how can the

40. Id. at 634, 526 P.2d at 1172, 116 Cal. Rptr. at 636.
41. Id. at 634, 526 P.2d at 1173, 116 Cal. Rptr. at 637.
42. Id.
43. Id. at 639, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
44. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).
line of decisions beginning with Murray and culminating in Wellenkamp be reconciled with the blanket approval of fixed price preemptive rights found in the decisions in Schwartz and Mercer?

One possible means of reconciling these cases involves drawing a meaningful distinction between the due-on provisions in La Sala, Tucker, and Wellenkamp and the preemptive provisions in Schwartz and Mercer. Regardless of this approach's initial appeal, however, it proves useless; both the Murray and Maynard decisions struck down preemptive provisions—results which are inconsistent with those in Schwartz and Mercer. Moreover, the factual context of the Maynard decision arguably is indistinguishable from that in Mercer.

A more plausible justification for the inconsistencies between the two lines of cases is that, since both Schwartz and Mercer were decided several months after Minderhout relaxed the ban on restraints on alienation, the courts in both cases might have concluded that the restraints imposed in those cases were justifiable under the new rule announced in Minderhout. This explanation, however, ignores the fact that neither the Schwartz nor the Mercer opinion cited the decision in Minderhout as authority for its conclusion.

The most obvious and inviting explanation for the Schwartz and Mercer decisions is that the courts deciding those cases simply were unaware of the decisions in Murray and Maynard. Indeed, neither the Schwartz nor the Mercer opinion makes reference to either of these cases.

Regardless of the explanation for the decisions in Schwartz and Mercer, the supreme court's present posture on restraints on alienation, as articulated in Wellenkamp, must be considered to assess accurately the treatment fixed price preemptive rights likely will receive in the future. This is particularly important in light of the fact that Wellenkamp emphasizes that restraints on alienation, although disfavored, may be upheld under certain circumstances. Thus, even assuming that the Schwartz and Mercer cases were decided incorrectly at the time, the question remains: under what circumstances, if any, should California acknowledge the validity of preemptive rights at fixed

46. See notes 25-30 & accompanying text supra.
47. Both Mercer and Maynard involved a buyer's obligation to offer a parcel of land first to his or her seller should the buyer ever wish to resell. See notes 20-22, 29-30 & accompanying text supra.
prices? In addressing this question, much can be learned from an examination of how other states view fixed price preemptive rights.

The Rule in Other States

According to the Restatement of Property, a best offer preemptive right is an acceptable restraint on alienation, provided it does not violate the rule against perpetuities. The Restatement further provides, however, that a fixed price or a "percentage offer" preemptive right is a valid restraint on alienation if, and only if, the restraint is reasonable under the circumstances. A review of the case law in various jurisdictions reveals that, although the majority of jurisdictions evaluate fixed price preemptive rights by their overall reasonableness, the standards of reasonableness which the various jurisdictions have adopted differ substantially.

Missouri State Highway Commission v. Stone represents one of the strictest tests of reasonableness. Defendant Stone, the owner of two adjoining lots, sold Lot 2 to appellant for $25,000. Shortly thereafter, appellant and Stone signed and recorded a document providing that should Stone or his heirs ever propose to sell Lot 1, appellant and his heirs would have the opportunity to buy Lot 1 for the sum of $10,000. The State Highway Commission subsequently condemned part of Lot 1. Both appellant and Stone asserted claims to the $4,500 condemnation award. The remaining portion of Lot 1 was at that time worth $15,000 to $18,000.

49. "A promissory restraint or forfeiture restraint on the alienation of a legal estate in land which is in the form of a provision that the owner of the estate shall not sell the same without first offering to a designated person the opportunity to meet, with reasonable expedition, any offer received, is valid, unless it violates the rule against perpetuities." Restatement of Property § 413(1) (1944).

50. A "percentage offer" preemptive right is a right to purchase property at a fixed percentage of the best offer received by the property's seller. See note 6 supra.

51. "A promissory restraint or forfeiture restraint on the alienation of a legal estate in land which is in the form of a provision
(a) that the owner of the estate shall not sell the same without first offering to sell to some designated person, either at a fixed price, or at a percentage of the price offered by another person, or
(b) that the owner of the estate shall pay a certain percentage of the sale price to some designated person, is valid if, and only if, the restraint is valid under the rules stated in §§ 406-411." Restatement of Property § 413(2) (1944). According to § 406 of the Restatement of Property, "a restraint on the alienation of a legal possessory estate in fee simple which is, or but for the restraint would be, indefeasible is valid if, and only if . . . the restraint is reasonable under the circumstances. . . ." Id. § 406.


53. 311 S.W.2d 588 (Mo. Ct. App. 1958).
The trial court found the preemptive right to be invalid. In affirming the decision of the trial court, the court of appeal first noted that the validity of a preemptive agreement depends upon whether the restraint created is reasonable. The court then laid out a test by which the reasonableness of preemptive rights could be evaluated. According to this test, "attention must be paid (among other things) to (a) the purpose or purposes for which the restraint is imposed; (b) the duration of the restraint; and (c) the method of determining the price to be paid." Finally, specifically addressing the validity of fixed price preemptive rights, the court noted that "a pre-emption of unlimited duration, requiring offer to the pre-emptioner for a specified sum of money, is the most objectionable type of pre-emption." While a method of determining price is essential to the validity of a pre-emption agreement, a fixed price is a substantial restraint. Applying the test to the facts before it, the court concluded that the fixed price preemptive right could not possibly serve any useful purpose.

In reaching its conclusion, the court in Stone relied on the earlier decision in Kershner v. Hurlbut, in which the Missouri Supreme Court invalidated an agreement giving the Joneses and Kershners, co-owners of a parcel of land, reciprocal preemptive rights to purchase one another's interest at the original purchase price. After a dispute arose between the parties, the Joneses sold their half of the parcel for more than three times the original purchase price without first offering it to the Kershners at the price fixed by the agreement.

The Kershners' request for specific performance of the preemption agreement was denied by the trial court. In affirming the judgment of the trial court, the supreme court recognized the problems inherent in fixed price preemptive provisions. As the court pointed out, "where the price is stipulated and the value of the property at the time it may be offered for sale is much greater than its value at the time of the contract, [fixed price preemptive agreements create] an obvious restraint on alienation, since the owner will retain the property rather than sell it at a great sacrifice."

Despite this language, the court was unwilling to explicitly hold

54. Id. at 589.
55. Id. at 590 (emphasis by the court).
56. Id. The court reasoned that "[i]f the property increases in value the owner is not liable to sell, and if it decreases in value the buyer is not likely to take advantage of his pre-emption right." Id.
57. 277 S.W.2d 619 (Mo. Sup. Ct. 1955).
58. Id. at 625.
that all preemptive rights at fixed prices are unconditionally void, but instead declared that all restraints should be judged upon their overall reasonableness under the particular facts and circumstances.\[59\] The court's subsequent discussion made it clear, however, that any litigant seeking enforcement of a fixed price preemptive right would face nearly insurmountable judicial intolerance, as evidenced by the court's conclusion that fixed price preemptive rights "[accomplish] nothing more, than to arbitrarily restrain the alienation of the lots for the lives of the respective parties. . . . It follows that no socially or economically desirable objective could be accomplished by enforcing this contract . . . ."\[60\]

The stand taken in *Stone* and *Kershner* does not express a universal rule.\[61\] In *Tovrea v. Umphress*,\[62\] for example, the Arizona Court of Appeals took a more liberal approach in evaluating the reasonableness of fixed price elements. In *Tovrea*, Della and Edward Tovrea acquired property located next to the family's incorporated business and used it as their residence. Upon Edward's death, the co-trustees under his will acquired his undivided one-half interest in the land. Shortly thereafter, these co-trustees quitclaimed their interest to Della. Simultaneously, the family corporation entered into an agreement with Della under which the corporation received a fixed price preemptive right to purchase the property.\[63\] The agreement further provided that should Della die still owning the property, the corporation would have the right to purchase the land from her estate on the same terms. Some twenty years later, the corporation assigned this preemptive right to Philip Tovrea. Upon his death, the preemptive right passed to the trustees under his will. When Della subsequently died, the trustees under Philip's will elected to exercise their right to purchase the property. The residuary legatees under Della's will commenced an action to quiet title to the property and Philip's trustees counterclaimed for specific performance.

In upholding the validity of the preemptive right, the court relied upon the factors set out in the comments to the Restatement of Property\[64\] which, when present, support the reasonableness of a particular

\[59\] *Id.* at 625-26.
\[60\] *Id.* at 626.
\[63\] Apparently the fixed price term agreed upon was essentially equivalent to one-half of the fair market value of the home at the time of the property's disposition. *Id.* at 515, 556 P.2d at 816.
\[64\] According to the comments to the Restatement, "[e]ven though a restraint on alien-
restraint on alienation. The court paid particular attention to three factors referred to in the Restatement: whether "the one imposing the restraint has some interest in land which he is seeking to protect by the enforcement of the restraint";65 whether "the restraint is limited in duration";66 and whether "the enforcement of the restraint accomplishes a worthwhile purpose."67

Applying these factors to the case before it, the court concluded that the restraint was reasonable under the circumstances.68 First, the party imposing the restraint, i.e., the family corporation, had a valid interest in land which it was seeking to protect by enforcement of the restraint: while Della occupied the land, the land acted as a "buffer zone that shielded the Company from possible nuisance complaints and litigation"69 and assured the corporation of convenient property for future expansion. Second, the restraint was limited in duration to the life of Della plus a short period after her death.70 Finally, the court felt that enforcement of the restraint accomplished a worthwhile pur-

The factors listed above as tending to support a conclusion that the restraint is reasonable and those listed as tending to the opposite conclusion are not exhaustive." RESTATEMENT OF PROPERTY § 406, Comment i (1944).

65. Id.
66. Id.
67. Id.
68. 27 Ariz. App. at 520, 556 P.2d at 821.
69. Id. at 518, 556 P.2d at 819.
70. Id.
pose: the widow Della was guaranteed the exclusive right of occupancy of her home during her lifetime.\textsuperscript{71} In light of these factors evidencing the reasonableness of the restraint, the court felt that the matter of price was more properly left for determination by the parties.\textsuperscript{72}

In \textit{Kintner v. Wruble},\textsuperscript{73} a Pennsylvania trial court adopted a significantly more lenient approach to evaluating the reasonableness of fixed price preemptive rights. Plaintiff, owner of a farm, was crippled with arthritis and spent most of his time in a hospital. The plaintiff desired to sell the farm, while retaining the farmhouse to live in while he was outside the hospital. Accordingly, he sold the farm, less the property upon which the house was built, to defendant, giving defendant the preemptive right to purchase the house for $500 should plaintiff or his heirs ever desire to sell it. Eleven years later, for reasons not stated in the opinion, plaintiff filed a complaint seeking to have the preemptive provision declared void as against public policy.

The court began its discussion by specifically rejecting the approach suggested in the Restatement of Property.\textsuperscript{74} Instead, the court chose to view preemptive rights as a type of absolute option to purchase, \textit{i.e.}, an option to purchase upon a condition precedent, the condition precedent being the owner's desire to sell. Thus, if and when the owner decides to sell and so notifies the optionee, the conditional provision matures into an absolute option. The court first noted the validity of option contracts in general and options upon condition precedent in particular.\textsuperscript{75} Having concluded that such preemptive rights were generally acceptable, the court focused on the fixed price element of the particular restraint before it. A review of decisions in other jurisdictions convinced the court that there was authority upholding fixed price preemptive rights in circumstances in which such restraints were reasonable.\textsuperscript{76} Yet the \textit{Kintner} court went even further, holding that a

\textsuperscript{71} \textit{Id.}
\textsuperscript{72} \textit{Id.} at 520, 556 P.2d at 821.
\textsuperscript{73} 17 Pa. D. & C.2d 574 (1958).
\textsuperscript{74} "We have read with much interest, but little profit, the restatement and the academic discussion contained therein. To try to follow the writer required considerable time, and in the end we, too, were on the sea of uncertainty." \textit{Id.} at 576.
\textsuperscript{75} "Of course, plaintiff's agreement involves a negative promise not to sell to anyone without giving defendant the first refusal, and to that extent it is a restraint on alienation, but that restraint is no more and no less than the same restraint on his right to sell to another when he has, for a consideration, given an absolute option. That partial restraint is recognized and upheld by all the courts. We submit that the useful, social purpose served by it is served equally by an option on condition. In each case, dealing at arm's length and for a consideration, the one grants a right to the other." \textit{Id.} at 577.
\textsuperscript{76} Ironically, the court relied heavily on the \textit{Kershner} decision as support for the "rea-
fixed price term alone could not render a preemptive right invalid.\textsuperscript{77} Despite the court’s extreme posture, it paid careful attention to the reasonableness of the contract’s underlying purpose, which, in view of the plaintiff’s physical infirmities, the court characterized as “laudable and legitimate.”\textsuperscript{78}

These cases illustrate that fixed price preemptive rights often are viewed as at least suspect and that no other jurisdiction appears to grant the unconditional validity conferred upon them by the California Court of Appeal in \textit{Schwartz} and \textit{Mercer}.

**Proposed Resolution in California**

As \textit{Tucker} and \textit{Wellenkamp} demonstrate, the California Supreme Court strongly disfavors restraints on alienation, yet will tolerate them when the justification for a particular restraint outweighs the quantum of restraint resulting therefrom.\textsuperscript{79} Applying this balancing test, however, may prove difficult and unduly restrictive in fixed price preemptive right cases.

First, it is difficult to imagine how a court would usefully assess the justification for a fixed price preemptive right. Consider, for example, \textit{Schwartz v. Shapiro},\textsuperscript{80} discussed earlier. Although the Shapiros clearly had a strong and understandable interest in determining their future business partners, there is no reason why a “best offer” preemptive right would not have served this purpose equally well. Consequently, the "reasonableness" approach. \textit{Id.} at 581-82. As noted above, the \textit{Kershner} court, while espousing reasonableness, appeared to be quite predisposed to find all fixed price preemptive rights unreasonable. See text accompanying note 58 \textit{supra}.

77. “Price is generally an essential ingredient of every contract for the transfer of property or interests therein and must be certain or capable of being ascertained by the terms of the contract. So, with every option contract, a fixed price or a means must be agreed upon to determine the price before it can be valid . . . . If a fixed price be necessary in an option, why should its presence in an option upon condition render it null and void?” \textit{Id.} at 583.

78. As the court noted: “It must be borne in mind that a small house is involved and that it should have been included in the sale of the entire farm. Only because of plaintiff’s ill health, only to accommodate him when he wanted to use it during his absence from the hospitals, did the grantee agree not to insist on its conveyance at the time. What is a farm without a home upon it? On the other hand, who would want to live in a small house next to a barn unless he had to in order to take care of the animals and the barn proper? . . . Here we have proof of the purpose of the parties inserting the covenant in the deed. And what is more, it is a reasonable provision agreed upon to carry out a laudable and legitimate purpose.” \textit{Id.} at 581.


80. \textit{229 Cal. App. 2d 238, 40 Cal. Rptr. 189 (1964)}. For a discussion of the \textit{Schwartz} case see text accompanying notes 12-19 \textit{supra}. 
under this test fixed price elements will fare poorly, absent unusual circumstances justifying a predetermined price.

Second, the quantum of restraint imposed by a fixed price preemptive right might prove difficult to assess. On the one hand, fixed price preemptive rights arguably impose less restraint than due-on-sale clauses: one owning land subject to a fixed price preemptive right is at all times free to convey the land and never faces anything so drastic as the foreclosure of a mortgage. Equally arguable, however, is that fixed price preemptive rights pose a potentially greater restraint than due-on-sale clauses. For example, although the plaintiffs in Tucker alleged a loss of only $3,700 resulting from enforcement of a due-on-sale clause, the plaintiffs in Schwartz lost some $28,500 by reason of a fixed price preemptive provision.

If the justification versus quantum of restraint test alone is insufficient to evaluate preemptive rights, California courts must find some workable resolution to eliminate the dangers inherent in fixed price preemptive agreements. While the California Supreme Court conceivably might adopt the position taken in Missouri State Highway Commission v. Stone,81 such a decision would be unfortunate; adoption of a rule creating a presumption against the validity of fixed price preemptive rights would virtually eliminate a court's discretion to uphold potentially reasonable provisions. As to adopting the liberal attitude embodied in Tovrea v. Umphress,82 the drastic erosion of the less liberal Minderhout decision is an indication that the California Supreme Court is not likely to look so favorably upon fixed price preemptive rights. A fortiori, the extreme approach taken by the Pennsylvania court in Kintner v. Wruble83 surely will find little support in California.

Recognizing the disfavor in which restraints on alienation are held in California, this Article proposes a method of analyzing fixed price preemptive provisions which will reinforce the California Supreme Court's pronounced attitude toward restraints on alienation without requiring an outright ban on such provisions. Although any court confronting a fixed price preemptive right certainly should attempt to balance the justification for the proposed restraint against the quantum of restraint resulting therefrom, consideration of two additional factors

81. 311 S.W.2d 588 (Mo. Ct. App. 1958). For a discussion of the Stone case see text accompanying notes 53-61 supra.
will aid significantly in an evaluation of fixed price preemptive rights. These two factors are the parity of bargaining power between the respective parties and intangible or nonmonetary consideration passing to the restrained party to compensate for later potential monetary loss.

Parity of Bargaining Power

A strong argument can be made that two parties of relatively equal business acumen and bargaining power should be free to enter into preemptive right provisions on whatever terms they subjectively determine to be satisfactory. While a fixed price preemptive right provision might produce a substantial monetary loss, it could be viewed as no more than an honest mistake in judgment resulting in a bad bargain—rarely, if ever, a defense to an otherwise valid contract.84 On the other hand, when the business acumen or bargaining power is not substantially equal between two parties, greater justification exists for a court to protect the weaker party from having a grossly unfavorable fixed price preemptive right imposed upon it.85

This analysis is consistent with the results obtained in most of the California cases discussed above. For example, in Wellenkamp, Tucker, and La Sala, the due-on clauses were not freely negotiated by the parties.86 Rather, individuals wishing to obtain financing from lending institutions were confronted with standard form contracts on a "take it or leave it" basis. In circumstances such as these, preemptive provisions, like all other forms of restraint on alienation, should be at least highly suspect.87


85. This argument more commonly is used to attack the validity of one or more provisions in an adhesion contract. For a general discussion of the validity of such contracts in California see Comment, Contracts of Adhesion Under California Law, 1 U.S.F. L. Rev. 306 (1967).

86. Notably, the court in Wellenkamp explicitly noted that it was limiting its holding to "institutional lenders," and did not address the enforceability of due-on clauses by "private vendors," presumably those who are on an equal bargaining level with individual purchasers. 21 Cal. App. 3d at 952, n.9, 582 P.2d at 976, 148 Cal. Rptr. at 385.

87. The significance of this first factor is somewhat diminished by the fact that fixed price preemptive provisions are not as frequently inserted into adhesion contracts as are the most popular due-on clauses. Hence, the frequency of seeing parties of disparate bargaining power litigating the validity of such provisions is expected to be quite small. Indeed, as the case law suggests, a fixed price preemptive provision is much more common between individuals who have negotiated the purchase of a piece of real estate. See, e.g., Tovrea v. Umphress, 27 Ariz. App. 513, 556 P.2d 814 (1976); Kintner v. Wruble, 17 Pa. D. & C.2d 574
Nonmonetary Consideration to Restrained Party

As the above analysis of decisional law in various jurisdictions indicates, fixed price preemptive agreements imposing reasonable restraints on alienation have on occasion been upheld. Courts holding preemptive provisions valid have emphasized special nonmonetary or intangible benefits passing to the grantor of the preemptive right, which compensated that party for the possibility of monetary loss resulting from subsequent enforcement of the right. Where such special consideration is found to have passed to the grantor of the preemptive right, a court reviewing the validity of the provision should be more reluctant to invalidate it, in spite of any apparent disparity between the fixed price term and the fair market value of the subject property.

This analysis is consistent with the cases validating fixed price preemptive rights discussed above. In Tovrea, for example, Ms. Tovrea entered into a fixed price preemptive agreement which obligated her, should she ever decide to sell her home, to sell it for approximately one half of its market value. In return for this monetary sacrifice, however, Ms. Tovrea was able to resolve a conflict with the heirs of her late husband which might have resulted in a forced sale of her home. In addition, she guaranteed the family corporation, of which she was a part owner, convenient land for future expansion. Under these circumstances, which the court emphasized, there is little reason for any court to deem such a contract unreasonable or against public policy.

Similarly, the plaintiff in Kintner, who was obligated to sell a potentially valuable house for the fixed price of $500, gained a great deal in the bargain. By agreeing to sell the farmhouse to the purchaser of the surrounding farm at a fixed price, if and when he decided to sell, Mr. Kintner was able to retain the home that was so important to him during the occasional periods when he was free to leave the hospital.

Turning this analysis to the Schwartz and Mercer decisions, it is impossible to discover any corresponding special nonmonetary consideration passing to the restrained parties. In Schwartz, each party to the agreement had a preemptive right to purchase the other party's interest in the subject property at a fixed price. The only nonmonetary benefit which each party acquired as a result of the preemptive right agreement was the ability to prevent the other party from selling to an unde-
sirable future purchaser. This benefit, however, could have been obtained with precisely equal efficiency by use of a best offer clause. The fixed price element thus became purely punitive, creating a windfall profit for the last party to sell.

Similarly, in Mercer, there was no indication that the party restrained by the fixed price provision received any special nonmonetary consideration in the bargain. On the contrary, the court recognized that the preemptive right had been granted solely as an incentive for the original purchaser to enter into the transaction. The consideration passing to the grantor of the preemptive right appears to have been strictly monetary.

Conclusion

The decisions in Schwartz and Mercer have stood for fifteen years without comment or criticism from the California Supreme Court. Nonetheless, recent California Supreme Court decisions demonstrate that the court is retreating from a permissive attitude toward restraints on alienation. If the court were confronted today with the question of the validity of a fixed price preemptive agreement, it certainly would demand a greater showing of reasonableness than that demanded in either Schwartz or Mercer.

In adjudicating the validity of any fixed price preemptive right, a court should, of course, attempt to apply the "justification versus quantum of restraint" test developed by the California Supreme Court for evaluating due-on clauses. Consideration of two additional factors, however, will aid a court in its determination of the validity of fixed price preemptive rights. These two factors are the parity of bargaining power between the respective parties and the special nonmonetary consideration given to the restrained party to compensate for the potential subsequent monetary loss.

By taking these factors into consideration, California courts should

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88. Indeed, the court in Schwartz mentioned that the parties had discussed the "possibility of either party selling his interest to 'someone not of the white race.'" Schwartz v. Shapiro, 229 Cal. App. 2d 238, 242-43, 40 Cal. Rptr. 189, 192 (1964). If the reason for the insertion of the preemptive provision was to prevent the sale of the subject property on the basis of the potential purchaser's race, there is an even greater reason for finding the preemptive provision in Schwartz both unreasonable and against public policy, particularly in light of such cases as Shelley v. Kramer, 334 U.S. 1 (1948).

89. As the court noted, "[t]estimony was given to the effect that parcel 1 would not have been purchased by plaintiffs without the hope that they could purchase the adjoining lot for $10,000 when and if defendant decided to sell." Mercer v. Lemmens, 230 Cal. App. 2d 167, 171, 40 Cal. Rptr. 803, 806 (1964).
achieve results both consonant with those reached in the majority of other jurisdictions today and compatible with the current California Supreme Court attitude toward restraints on alienation.