

Title: Equatorial Realty Development, Inc. & Carmelo & Bauermann, Inc. vs. Mayfair Theater, Inc.

Facts:

Carmelo owned a property at Claro M. Recto Avenue, Manila, which included two 2-storey buildings. It entered into lease contracts with Mayfair in 1967 and 1969, covering portions of the property for use as motion picture theaters, valid for 20 years. Both contracts contained an identical "option clause," giving Mayfair the exclusive option to purchase the leased premises should Carmelo decide to sell them. In August 1974, Carmelo, through Mr. Pascal, hinted at selling the property to Mayfair, pricing it at Six to Seven Million Pesos against an external offer of US Dollars 1,200,000. This initiated a series of correspondences without concluding the negotiations.

In 1978, Carmelo sold the entire property to Equatorial for P11,300,000.00. Mayfair sued for specific performance and annulment of the sale, alleging breach of the option clause. The trial court dismissed the complaint, ruling the option clause void for lack of consideration. The Court of Appeals reversed this decision, declaring the clause a right of first refusal, not an option contract, and ordered the sale to Equatorial rescinded for Mayfair to purchase the property at the same price Carmelo sold it.

Issues:

1. Whether the option clause in the lease contract constituted an offer or a right of first refusal.
2. Whether the clause required a separate consideration to be valid.
3. Whether the sale to Equatorial was valid despite Mayfair's right under the lease agreements.
4. Whether Mayfair is entitled to enforce the right of first refusal to acquire the property.

Court's Decision:

The Supreme Court upheld the Court of Appeals' ruling, agreeing that the clause granted a right of first refusal, not an option contract, hence not requiring a separate consideration. The Court found Carmelo and Equatorial acted in bad faith by not fulfilling this right when the property was sold to Equatorial. It ordered the sale rescinded and directed Equatorial to return the property to Carmelo, which in turn should offer it to Mayfair for the original sale price.

Doctrine:

The decision established that a right of first refusal contained within a lease agreement does not require a separate consideration to be valid and enforceable. Furthermore, a sale that violates a lessee's right of first refusal, especially when done in bad faith, can be rescinded to allow the lessee to exercise such right.

Class Notes:

- Option contracts vs. Right of first refusal: Option contracts require a distinct consideration apart from the price, detailing a fixed offer period and price, while a right of first refusal needs no separate consideration and offers the holder a chance to match offers received by the seller.
- Bad Faith and Rescission: The sale made in disregard of a pre-existing right of first refusal, especially when made in bad faith, is subject to rescission, allowing the aggrieved party the opportunity to acquire the property.
- Lease agreements incorporating rights of first refusal must expressly stipulate this right but need not have a separate consideration for it to be valid and binding.

Historical Background:

The rule distinguishing between an option and a right of first refusal, particularly in the context of lease agreements, underscores the primacy of good faith in contractual dealings. This case illustrates how commercial property transactions can be complicated by pre-existing contractual rights, highlighting the need for parties to thoroughly understand and respect such rights in their transactions.