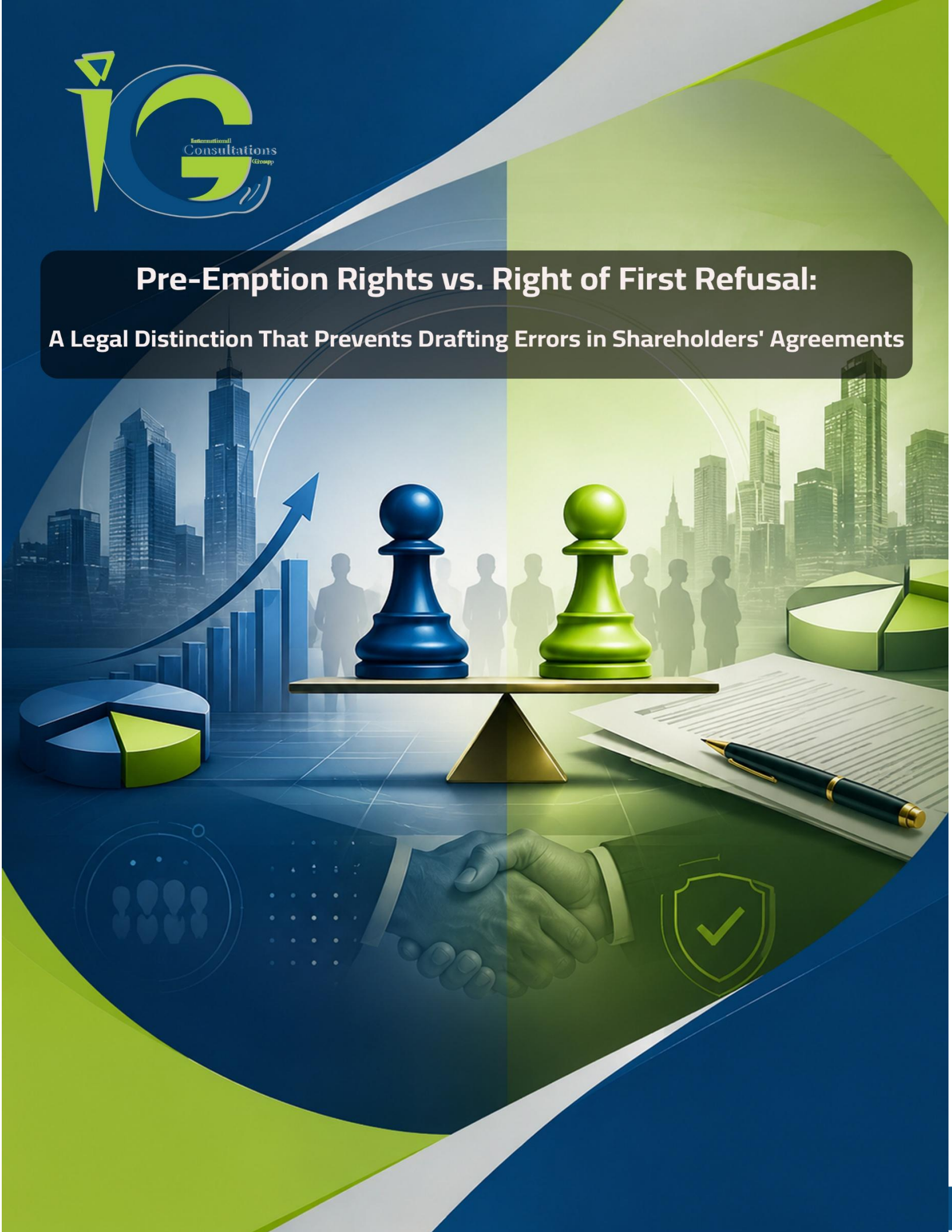




Pre-Emption Rights vs. Right of First Refusal:

A Legal Distinction That Prevents Drafting Errors in Shareholders' Agreements





Introduction

Shareholders' Agreements are among the most significant legal instruments governing the relationship between shareholders within a company. They define the parties' rights and obligations, establish corporate governance mechanisms, regulate the transfer of shares, and provide a contractual framework that minimizes potential disputes while preserving the stability of the company's ownership structure. Among the most critical provisions in these agreements are those governing restrictions on share transfers and the preferential rights granted to shareholders.

Although the terms **Pre-Emption Rights** and **Right of First Refusal (ROFR)** are frequently used in shareholders' agreements and commercial contracts, they are often treated as though they are interchangeable. In reality, each serves a distinct legal function, applies within a different legal context, and produces different practical consequences depending on the event that triggers the right.

This confusion extends beyond terminology or linguistic differences and often affects legal practice, particularly in cross-border transactions involving both **Common Law** and **Civil Law** jurisdictions. In some legal systems, the term **Pre-Emption Rights** is used to describe rights relating to the transfer of existing shares, whereas in others it refers exclusively to shareholders' preferential rights to subscribe for newly issued shares. Such conceptual divergence may create significant legal risks affecting the interpretation of the agreement, the rights of shareholders, and even the validity or enforceability of the underlying transaction.

Accordingly, the distinction between these two rights should not be determined by the title of the contractual provision or the terminology adopted in the



agreement. Rather, it should be determined by the **legal event that triggers the right (the Trigger Event)**. Where the right arises upon the company's issuance of new shares, it constitutes a **Pre-Emption Right**, granting existing shareholders the priority to subscribe for those newly issued shares in proportion to their existing holdings. Conversely, where the right arises because an existing shareholder intends to sell their shares after receiving a bona fide offer from a third party, it constitutes a **Right of First Refusal (ROFR)**, regardless of the terminology used in the agreement.

First: Right of First Refusal (ROFR)

1. Definition of the Right of First Refusal

The **Right of First Refusal (ROFR)** is a contractual right that grants one or more shareholders the priority to purchase shares that another shareholder intends to sell before those shares may be transferred to an external third party. The purpose of this right is to enable the holders of the ROFR to step into the position of the proposed third-party purchaser, provided that they agree to acquire the shares on the same terms and conditions offered by that third party.

The ROFR is characterized as a **reactive right**, meaning that it does not arise merely because a shareholder wishes to sell their shares. Rather, it is triggered only when the shareholder has received a bona fide offer from a third party and intends to accept that offer.

2. Legal Nature of the Right

The Right of First Refusal is a purely contractual right. As a general rule, it does not arise by operation of law but derives its existence solely from the parties' agreement, whether contained in a **Shareholders' Agreement**, the company's



Articles of Association (or Constitutional Documents), or any other binding agreement between the parties. Accordingly, the scope of the right, the procedures governing its exercise, the applicable timeframes, and the consequences of any breach are all determined by the contractual arrangements agreed upon by the parties.

3. When Does the Right Arise?

The Right of First Refusal is triggered when a shareholder receives a bona fide offer from a third party to purchase their shares and wishes to accept that offer. In such circumstances, the shareholder is not entitled to complete the sale directly. Instead, the shareholder must first offer the shares to the holders of the ROFR on the same terms and conditions contained in the third-party offer.

Accordingly, the existence of a genuine third-party offer constitutes the essential triggering event for the ROFR. In the absence of such an offer, no obligation arises to offer the shares to the holders of the right.

4. Procedure for Exercising the Right

The exercise of the Right of First Refusal begins with the selling shareholder notifying the holders of the right of their intention to sell and providing all material terms of the third-party offer. Such notice typically includes the number of shares offered for sale, the purchase price, the payment mechanism, and any other material terms and conditions of the proposed transaction.

The holders of the ROFR are then granted a specified period within which they may elect to purchase the shares on identical terms. If they exercise the right within the prescribed period, the selling shareholder is obligated to complete the sale in their favour. Conversely, if the holders fail to exercise the right within the applicable period, or expressly waive it, the selling shareholder is free to complete



the sale to the third-party purchaser on the same terms previously offered to the ROFR holders.

5. Purpose of the Right of First Refusal

The Right of First Refusal serves several important commercial and legal objectives. Most notably, it helps preserve the stability of the company's ownership structure, prevents the admission of new shareholders whose interests may not align with those of the existing shareholders, and enables the current shareholders to maintain control over the composition of the company and the dynamics of their relationship. For these reasons, the ROFR is widely regarded as one of the principal mechanisms for regulating share transfers in **closely held companies, startups, and investment agreements.**

Second: Pre-Emption Rights

1. Definition of Pre-Emption Rights

Pre-Emption Rights are the rights of existing shareholders to subscribe for newly issued shares before such shares are offered to third parties. These rights are generally exercised in proportion to each shareholder's existing ownership interest, thereby preserving their percentage of ownership and voting rights within the company.

This right is fundamentally different from the **Right of First Refusal (ROFR)**. Whereas ROFR concerns the transfer of **existing shares** between shareholders and third parties, Pre-Emption Rights relate exclusively to the **issuance of new shares by the company.**

2. Legal Nature of the Right



In many jurisdictions, Pre-Emption Rights are statutory rights established under company law to protect existing shareholders from dilution. As a general rule, these rights arise by operation of law unless they are lawfully excluded, waived, or modified in accordance with the procedures prescribed by the applicable legislation.

In addition, companies frequently supplement the statutory framework by regulating the detailed procedures governing the exercise of these rights in their **Articles of Association** or **Shareholders' Agreements**, provided that such arrangements remain consistent with the applicable law.

3. When Does the Right Arise?

Pre-Emption Rights arise when the company resolves to issue new shares or increase its share capital. Before offering those shares to new investors, the company must first offer them to its existing shareholders in accordance with their respective ownership interests.

Accordingly, the triggering event is **the company's issuance of new shares**, rather than any disposition of existing shares by a shareholder.

4. Purpose of the Right

The principal purpose of Pre-Emption Rights is to protect existing shareholders against **equity dilution (Anti-Dilution)** resulting from the issuance of new shares. By allowing shareholders to maintain their proportional ownership, these rights preserve their economic interests and voting power, while preventing shifts in corporate control or influence that could otherwise occur through the admission of new investors without first giving existing shareholders the opportunity to preserve their legal and economic positions.



5. Exercise of the Right

Pre-Emption Rights are exercised by the company offering newly issued shares to existing shareholders in proportion to their current shareholdings, within a specified subscription period.

If a shareholder elects to subscribe for their allotted shares, they preserve their ownership percentage following the capital increase. Conversely, if a shareholder declines to exercise the right or fails to subscribe within the prescribed period, the company may offer the remaining shares to third-party investors in accordance with the applicable law or the relevant contractual arrangements.

Third: Why Are These Two Rights Frequently Confused?

Despite the fundamental distinction between the **Right of First Refusal (ROFR)** and **Pre-Emption Rights**, practice demonstrates that the two concepts are frequently confused in shareholders' agreements and commercial contracts, not only by practitioners but also in certain international contractual precedents.

This confusion is attributable not merely to the similarity of the terminology, but also to several legal and drafting considerations, including differences between legal traditions, inconsistencies in the terminology used in international agreements, and the impact of the governing law on the interpretation of these rights.

1. Differences Between Legal Systems

One of the principal causes of confusion stems from the conceptual differences between **Common Law** and **Civil Law** jurisdictions.

Under Common Law systems, the **Right of First Refusal (ROFR)** refers to the right that arises when a shareholder intends to sell their shares after receiving a bona



vide offer from a third party. By contrast, the term **Pre-Emption Rights** is generally reserved for the preferential right of existing shareholders to subscribe for newly issued shares in order to preserve their ownership interests.

However, in certain Civil Law jurisdictions, the term **Pre-Emption Right** may also be used to describe the preferential right to acquire existing shares before they are transferred to a third party. Consequently, the same expression may refer to two entirely different legal mechanisms depending on the governing legal system.

Accordingly, the mere appearance of the term **"Pre-Emption"** in an agreement is insufficient to determine the nature of the right. Rather, the contractual provision must be interpreted by reference to its substantive content and the legal event that triggers its operation.

2. International Drafting and Translation

International contracts and shareholders' agreements prepared using foreign precedents have further contributed to this confusion. Contractual provisions are sometimes translated or transplanted from one legal system into another without due regard to the different legal meanings attached to the terminology.

For example, certain agreements contain a provision entitled **"Pre-Emption Rights"**, while the substance of the clause regulates the transfer of existing shares between shareholders. Under the Common Law understanding, such a provision would in fact constitute a **Right of First Refusal** rather than a true pre-emption right.

Conversely, some agreements use the heading **"Right of First Refusal"** while regulating shareholders' preferential rights to subscribe for newly issued shares.



This issue is particularly significant in cross-border transactions, where English-language drafting precedents interact with Civil Law legal systems throughout the Middle East and North Africa. In such cases, reliance on the title of a clause alone is insufficient to determine the rights and obligations it creates.

3. The Impact of the Governing Law

The governing law plays a decisive role in the interpretation of shareholders' agreements, as identical legal terminology may carry different meanings depending on the applicable legal system.

For example, an agreement governed by **English law** will ordinarily interpret **Pre-Emption Rights** as rights relating to the subscription for newly issued shares. In contrast, some other legal systems may interpret the same expression as referring to a preferential right to acquire existing shares before their transfer.

Accordingly, careful drafting requires more than merely adopting familiar legal terminology. The agreement should expressly define each right, specify its scope, and identify the legal event that triggers it. Doing so minimizes the risk of conflicting interpretations and future disputes.

Fourth: The Correct Test for Distinguishing Between the Two Rights

Rather than focusing on the title of the contractual provision, the correct legal analysis begins with a single question:

What is the legal event that triggers the right (the Trigger Event)?

If the right arises because the company issues new shares or increases its share capital, the right is a **Pre-Emption Right**, the purpose of which is to protect shareholders against dilution.

Conversely, if the right arises only when an existing shareholder wishes to sell their shares after receiving a bona fide third-party offer, the right is a **Right of First Refusal (ROFR)**, regardless of the label used in the agreement.

Accordingly, the **Trigger Event** constitutes the true legal criterion for distinguishing between these two mechanisms—not the terminology adopted in the heading of the contractual provision.

Criterion	Right of First Refusal (ROFR)	Pre-Emption Rights
Source of the Right	Contractual right established by agreement between the parties	Generally a statutory right, which may also be supplemented or regulated contractually
Trigger Event	A shareholder intends to sell existing shares after receiving a bona fide third-party offer	The company issues new shares or resolves to increase its share capital
Third-Party Offer Required	Yes—an essential prerequisite	No
Primary Purpose	To regulate share transfers and control the admission of new shareholders	To protect shareholders against equity dilution (Anti-Dilution)
Subject Matter	Existing shares	Newly issued shares



Fifth: Legal and Practical Implications of the Distinction

The distinction between the **Right of First Refusal (ROFR)** and **Pre-Emption Rights** is not merely theoretical or terminological. Rather, it has significant legal and commercial consequences affecting the company's ownership structure, shareholders' rights, investment attractiveness, financing transactions, and exit mechanisms. The principal implications include the following:

1. Control over the Shareholding Structure

The Right of First Refusal is one of the most effective contractual mechanisms for controlling the transfer of shares. It grants existing shareholders the priority to acquire shares offered for sale before they may be transferred to a third party. As a result, it limits the admission of new shareholders whose interests may not align with those of the company or the existing shareholders, thereby promoting ownership stability and reducing the likelihood of future shareholder disputes.

By contrast, Pre-Emption Rights are not intended to regulate transfers of existing shares. Instead, they are designed to preserve shareholders' proportional ownership interests when the company issues new shares.

2. Protection Against Dilution

Pre-Emption Rights constitute one of the principal legal mechanisms for protecting shareholders against **equity dilution**. By granting existing shareholders the preferential right to subscribe for newly issued shares in proportion to their existing holdings, these rights enable them to preserve their ownership percentages, economic interests, and voting power within the company.



The Right of First Refusal, on the other hand, provides no protection against dilution because it does not relate to increases in share capital or the issuance of new shares. Its function is limited to regulating the transfer of existing shares between shareholders and third parties.

3. Impact on Investment Rounds

Each right affects investment transactions in a different manner.

In financing rounds involving an increase in share capital, Pre-Emption Rights represent a critical consideration before new shares can be issued to investors. The exercise of these rights may alter the structure of the transaction, the size of the investment, or the percentage ownership ultimately acquired by the incoming investor.

Conversely, the Right of First Refusal assumes greater importance in **secondary share sales**, where an investor seeks to acquire existing shares from current shareholders. In such transactions, the ROFR may give existing shareholders the opportunity to acquire the shares before they are transferred to the prospective investor, thereby affecting both the structure and the timing of the transaction.

4. Impact on Exit Transactions

When a shareholder wishes to exit the company, the Right of First Refusal plays a central role in regulating the transfer of shares by ensuring that existing shareholders have the first opportunity to preserve the company's ownership structure before a new investor is admitted.

Pre-Emption Rights, by contrast, are generally unrelated to shareholder exit transactions. Their operation is confined to corporate decisions involving capital



increases and the issuance of new shares, making them significantly more relevant to financing rounds than to share sales or exit transactions.

5. Risks of Inaccurate Drafting

Using the terms **ROFR** and **Pre-Emption Rights** interchangeably, or relying solely on the title of a contractual provision without clearly defining its substantive effect, may give rise to unintended legal consequences. These include disputes over the applicability of the relevant right, delays in implementing investment or exit transactions, and judicial or arbitral interpretations that diverge from the parties' original intentions.

Accordingly, best drafting practices require each right to be defined separately within the agreement, with clear identification of its triggering event, the procedures governing its exercise, and its legal consequences, while ensuring consistency with the governing legal system.

Sixth: The Position under Egyptian Law

Egyptian law distinguishes between rights conferred directly by legislation and rights created by contractual agreement.

With respect to **Pre-Emption Rights**, the **Egyptian Companies Law** and its **Executive Regulations** recognize shareholders' preferential rights upon capital increases through the issuance of new cash shares. These rights are intended to protect shareholders from the dilution of their ownership interests, while also prescribing the circumstances and procedures under which such rights may lawfully be restricted or excluded.

By contrast, the **Right of First Refusal (ROFR)** is not established as a general statutory right under Egyptian company law. Instead, it is a contractual



mechanism that may be incorporated into a **Shareholders' Agreement** or the company's **Articles of Association**, provided that it does not contravene mandatory legal provisions or public policy and that its exercise mechanism is clearly defined.

Accordingly, Egyptian law recognizes both legal mechanisms, but their legal sources differ fundamentally. **Pre-Emption Rights** derive primarily from statutory company law, whereas the **Right of First Refusal** derives from the parties' contractual arrangements. This distinction should be carefully observed when drafting shareholders' agreements governed by Egyptian law.

Seventh: Practical Drafting Recommendations

In light of the foregoing, legal practitioners should observe the following drafting principles in order to minimize disputes and ensure precision in shareholders' agreements:

- **Do not rely solely on the heading or terminology** of a contractual provision to determine the nature of the right.
- **Define the Right of First Refusal and Pre-Emption Rights separately and expressly** within the agreement.
- **Identify the relevant Trigger Event** for each right, as this constitutes the decisive criterion for distinguishing between them.
- **Clearly distinguish between transfers of existing shares and the issuance of new shares**, and avoid combining both mechanisms within a single provision unless their respective scope is expressly delineated.



- **Ensure consistency between the drafting and the governing law**, particularly in agreements involving cross-border transactions or foreign legal elements.
- **Avoid literal translation of legal terminology**. Instead, use terminology that accurately reflects the legal substance of the provision rather than its linguistic equivalent.

Conclusion

At first glance, the distinction between **Pre-Emption Rights** and the **Right of First Refusal (ROFR)** may appear to be nothing more than a difference in terminology. In practice, however, each serves a distinct legal function and produces different consequences for the company's ownership structure, shareholders' rights, investment rounds, and exit transactions.

Pre-Emption Rights are designed to protect existing shareholders from the dilution of their ownership interests when the company issues new shares. By contrast, the **Right of First Refusal** is intended to regulate the transfer of existing shares by giving current shareholders the opportunity to acquire those shares before they are transferred to a third party.

Accordingly, sound legal drafting does not depend on the title of a contractual provision, but rather on a clear understanding of the **legal event that triggers the right**, together with a precise definition of its scope, exercise mechanism, and legal consequences. In shareholders' agreements, what appears to be a subtle distinction can ultimately determine whether an agreement provides legal certainty and preserves the parties' commercial expectations, or instead gives rise to avoidable disputes that could have been prevented at the drafting stage.