

BUYER REMEDIES IN SALE AND PURCHASE CONTRACTS

Recommendations for more equitable provisions in default and remedy sections of sale and purchase contracts.

Glenn Taxman

For the past decade, sellers have enjoyed a fertile market with many buyers bidding sale prices higher and driving cap rates lower. The standard sale and purchase contract has evolved into a one-sided document containing seller-favorable provisions. While these provisions are hard for buyers to stomach, sophisticated buyers may be willing to accept them because, in most cases, they have the right to terminate the contract and receive back their earnest money during the feasibility period. However, the most inequitable provisions are found in the default and remedy sections. Buyers are most vulnerable under these provisions as they have virtually no control over the seller. Yet, there are alternatives that offer more effective protection for the buyer.

Glenn D. Taxman, a principal with the Chicago-based law firm, Much Shelist, heads the firm's Orange County, California office.

STANDARD BUYER REMEDY CLAUSE

"If seller defaults under this agreement, buyer must elect, by written notice to seller, one of the following two options as buyer's sole and exclusive remedy at law or in equity: (i) termination of this agreement, in which event the earnest money will be returned to buyer and the parties will have no further obligations under this agreement, except as to those obligations which survive by their terms; or (ii) specific performance of this agreement, in which event buyer will be entitled to have a court of competent jurisdiction require seller to convey title to the property to buyer in accordance with the terms of this agreement."

The most troublesome issue with this clause is that the buyer's only "real" recourse is its right to elect to pursue an action for specific performance. This presents three problems.

- An action for specific performance can be lengthy and expensive and, even if the buyer prevails and the contract contained a prevailing party clause, there is no guarantee that the presiding judge will enforce the prevailing party clause.

- The property might be the buyer's replacement property under a tax-deferred exchange, which contains strict time frames under which the buyer must close on its acquisition. Therefore, the buyer might be better served by terminating the contract and looking elsewhere to satisfy its trade as compared to protracted litigation that could last beyond the required tax-deferred acquisition date.

- It is possible that the seller has already conveyed the property to a different buyer (who is unaware of the existing contract). In this case, an action for specific performance will not be available to the buyer since a third-party bona fide purchaser who had no notice of the existing contract now holds title.

In these instances the buyer is left with the right to terminate the contract and receive a return of the earnest money — basically no remedy at all since the buyer has already expended monies during the feasibility period. Most sellers are aware of these issues and may agree to modify the standard default/remedy clause.

"If seller defaults under this agreement, buyer must elect, by written notice to seller, one of the following two options as buyer's sole and exclusive remedy at law or in equity: (i) termination of this agreement, in which event the earnest money will be returned to buyer and the parties will have no further obligations under this agreement, except as to those obligations which survive by their terms [and seller will immediately reimburse buyer for its actual out-of-pocket expenses (including attorneys' fees) not to exceed \$_____]; or (ii) specific performance of this agreement, in which event buyer will be entitled to have a court of competent jurisdiction require seller to convey title to the property to buyer in accordance with the terms of this agreement."

This revised clause incorporates the seller's obligation to reimburse the buyer for its out-of-pocket costs upon the buyer's election to terminate the transaction. The buyer's counsel may initially ask for unlimited out-of-pockets; however, all sellers will insist on a cap, which will need to be negotiated between the parties. Before agreeing on a cap amount, the buyer must seriously evaluate its expected costs during the feasibility period. For example, is the buyer responsible for any of the title, survey and environmental costs? Furthermore, how many properties and buildings are being purchased? Are leases being reviewed and, if so, how many? All of these items increase the buyer's

likely out-of-pocket costs during the feasibility period. As a practical matter, if the seller's sole remedy for the buyer's breach is retention of the earnest money as liquidated damages, it is highly unlikely that the seller will agree to cap the out-of-pocket reimbursement at an amount higher than the earnest money.

While the out-of-pocket reimbursement provision is a nice deterrent to a seller breach, it does not address the three specific performance issues. Moreover, sellers are not inclined to permit buyers a right to pursue damages since such a claim would, among other things, permit a buyer to record a lis pendens against the property — thus making it difficult to market.

"[This section contains buyer's sole and exclusive remedies at law or in equity.]

A. If seller defaults under this agreement, buyer must elect, by written notice to seller, one of the following three options: (i) [if seller's default is other than its intentional failure to convey the property to buyer,] termination of this agreement, in which event the earnest money will be returned to buyer and the parties will have no further obligations under this agreement, except as to those obligations which survive by their terms and seller will immediately reimburse buyer for its actual out-of-pocket expenses (including attorneys' fees) not to exceed \$_____; (ii) [if seller's default is its intentional failure to convey the property to buyer ("Conveyance Default #1"), termination of this agreement and, in addition to buyer receiving the amounts set forth under subparagraph (i) above, seller will immediately pay to buyer, as liquidated damages in lieu of all other remedies available to buyer, an amount equal to twenty percent (20%) of the purchase price (the "Liquidated Payment")]; or (iii) specific performance of this agreement, in which event buyer will be entitled to have a court of competent jurisdiction require seller to convey title to the property to buyer in accordance with the terms of this agreement.

B. [If buyer elects specific performance but seller is unable to perform because seller no longer owns the property ("Conveyance Default #2"; together with Conveyance Default #1 are sometimes collectively referred to as a "Conveyance Default"), then, in addition to buyer receiving the amounts set forth under subparagraph (i) above, seller will immediately pay to buyer the Liquidated Payment.

In regard to a Conveyance Default, seller and buyer acknowledge and agree that:

1. It would be extremely difficult to accurately determine the amount of damages suffered by buyer as a result of seller's Conveyance Default;

2. The Liquidated Payment is a fair and reasonable estimate of the damages that might result from a Conveyance Default;
and

3. Payment of the Liquidated Payment by seller upon the Conveyance Default is not intended to be a penalty or forfeiture.

C. Except as expressly set forth in this section, in no event will buyer be entitled to recover from seller any actual, consequential, or incidental damages.]"

The conveyance default concept best resolves the three specific performance issues by:

- avoiding lengthy and expensive litigation;
- permitting the buyer to look elsewhere for a replacement property under its tax-deferred exchange while compensating it for the possible payment of capital gain's tax if not successful in timely finding and closing on another property; and
- compensating the buyer where the property was previously conveyed to a bona fide purchaser.

In addition, the conveyance default also provides the buyer with an additional option if a seller is unwilling to convey the property. Finally, and equally as important, the conveyance default addresses a seller's concerns such as (1) assuring that no lis pendens is recorded against the property; (2) avoiding lengthy and costly litigation subjecting seller to public exposure; and (3) knowing the monetary amount of its exposure.

The conveyance default is not the perfect buyer remedy as it fails to cover other types of seller defaults (such as failure to deliver due diligence items and a false representation or warranty) and does not prevent a seller from conveying the property to a bona fide purchaser for an amount greater than the liquidated payment plus the buyer's cap on out-of-pockets. However, buyers are most fearful of sellers causing a conveyance default and no remedy (that a seller would agree to) can prevent a "bad" seller from selling the property to a bona fide purchaser. Accordingly, buyers should demand that sellers include the conveyance default concept in all contracts. It is a simple, fair remedy that provides protection to both the buyer and the seller.