



Buyers spend a tremendous amount of time negotiating seller representations, warranties and covenants, and often neglect the very provision by which they may be enforced.

## THE TYPICAL PROVISION

A fairly typical remedies clause in a real estate purchase and sale agreement (PSA) provides that if the closing fails to occur as the result of a seller default, the buyer, as its sole alternative remedy, can either (i) terminate the PSA and recover its earnest money; or (ii) seek specific performance of the seller's obligations.

The above typical clause has a number of issues, many of which go unnoticed until there is a material seller default. Seller defaults fall into one of two categories, those that arise pre-closing and those that arise post-closing.

## PRE-CLOSING SELLER DEFAULTS UNDER THE TYPICAL PROVISION

Lawyers refer to recovery of the earnest money alternative set forth above as a "liquidated" damages provision – an amount agreed to as an estimation of actual damages in the event of a default. The amount is fixed as the measure of damages for a default, regardless of whether actual damages incurred exceed or fall short of the agreed amount. In the universe of available legal remedies, the return of earnest money is extremely limited and should at a minimum be expanded to add the right for the buyer to recover all or a portion of its actual out-of-pocket expenses incurred in connection with its negotiation and due diligence under the PSA.

On the other hand, the specific performance alternative is a remedy where the buyer requires that the property be conveyed in accordance with the terms of the PSA. While this remedy may sound good in theory, as a practical matter it has several limitations, including: (a) the seller may stop maintaining the property when it is subject to litigation, thus, causing deterioration and rent loss; (b) the remedy is equitable in nature and may be granted only in a court's discretion (even when the contract is clear); (c) the delay and expense of litigation reducing the net effective monetary realization; and (d) most importantly, specific performance may not be available when a third party is involved (i.e., the seller sold or is trying to sell the property to someone else). In this last instance, where there is a title blemish related to the seller's own actions, the buyer should be allowed to recover all damages at law and avail itself to other equitable relief.

Last, parties should consider notice/cure periods and materiality thresholds before remedies are triggered. In a rising interest rate environment for sizable transactions, interest on the earnest money should be recoverable as well.

## POST-CLOSING SELLER DEFAULTS UNDER THE TYPICAL PROVISION

Regardless of the pre-closing remedy chosen, the "typical" remedies provision is completely devoid of post-closing remedies. In situations where the remedies provision addresses only seller defaults that occur prior to closing, even if the PSA provides for the survival for representations and warranties, courts may treat the lack of specified remedies available after closing as an implicit waiver of the seller's representations and warranties upon delivery of the deed at closing.

A well drafted PSA will specify the scope (at a minimum to cover seller representations and warranties), duration (survival), and potential liability (dollars) associated with seller defaults that arise post-closing. The liability component will have a floor and ceiling (a/k/a minimum and maximum, basket and cap, etc.), and fraud and willful/grossly negligent defaults should be excluded from the floor and ceiling.

Since most sellers are likely to be single purpose entities with no assets aside from the property being sold and the resulting net proceeds from the sale (which will be immediately distributed), the issue of post-closing security should be addressed. Increasing market prices for property have allowed for more buyer friendly ancillary PSA terms and post-closing security is no longer aspirational. A buyer should consider asking its seller to secure its post-closing obligations with any of the following: (a) an escrow of a certain portion of the net proceeds as a "hold back" from the closing; (b) a guaranty from a third-party with assets; (c) a letter of credit; (d) insurance covering representations and warranties; or (e) other creative collateral. Although not ideal security, a covenant of the seller to maintain a minimum net worth and/or liquidity after closing is another alternative.

As you enter into your next PSA be sure to remember these few words of wisdom: make sure there is proper recourse if your seller defaults.