

Strafford

Presenting a live 90-minute webinar with interactive Q&A

Remedies Provisions in Commercial Real Estate Sales Contracts

Strategies for Buyers and Sellers Negotiating and Enforcing Default Clauses

TUESDAY, MAY 31, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Larry N. Woodard, Shareholder, **Robbins Salomon & Patt**, Chicago

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service** at **1-800-926-7926 ext. 10**.

Conference Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Continuing Education Credits

FOR LIVE EVENT ONLY

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- Close the notification box
- In the chat box, type (1) your company name and (2) the number of attendees at your location
- Click the blue icon beside the box to send

Tips for Optimal Quality

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory and you are listening via your computer speakers, you may listen via the phone: dial **1-866-873-1442** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail **sound@straffordpub.com** immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Remedies Provisions in Commercial Real Estate Sales Contracts

Tuesday May 31, 2011

Larry N. Woodard

ROBBINS SALOMON & PATT, LTD.

25 E. Washington St., 10th Floor

Chicago, Illinois 60602

(312) 782-9000

LWoodard@rsplaw.com

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract Remedies 101

Remedies at Law

- > Compensatory Damages
- > Incidental Damages
- > Consequential Damages
- > Punitive Damages

Remedies in Equity

- > Specific Performance
- > Rescission
- > Reformation
- > Injunctive Relief

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract Remedies 101: Remedies at Law

Compensatory Damages

- “Benefit of the Bargain”
- Place in the position as if the Contract had been performed
- *For Real Estate:* Difference between the contract price and the value of the property on the closing date (assumes higher price)
- *For Real Estate:* Lost profit if market value does not fully compensate

Incidental Damages

- “Return to *Status Quo Ante*”
- *For Real Estate:* Return costs and fees in performing contract (pre-closing)
- *For Real Estate:* Pay for interest paid on acquisition loan (post-closing)

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract Remedies 101: Remedies at Law

Consequential Damages

- Lost Profit; Damages Reasonably Foreseeable
- Largest potential for exposure; Beyond Incidental damages; Damages arising naturally from the breach
- *For Real Estate*: Carrying costs; Interest paid; Costs in reliance on contract performance; Lost profit of best possible alternative (that can be proven); Tax consequences (failed 1031 if known); Higher interest rates

Punitive Damages

- Punish the Evil Doer!
- Limited to tortious conduct: fraud, malice, misrepresentation, tortious interference
- *For Real Estate*: Rare; Need extreme circumstances and ability to meet high burden to prove fraudulent or malicious conduct

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract Remedies 101: Remedies in Equity

Specific Performance

- Court compels the purchase or sale of real estate
- Nonfungible uniqueness of land
- Not automatic for sellers (e.g. *Suchan v. Rutherford*, 410 P.2d 434 (Idaho 1986); *Centex Homes Corp. v. Boag*, 320 A.2d 194 (N.J. Super. Ct. 1974) (denying seller specific performance for farm land and condominium, respectively, because it was not unique and could be resold)
- Other damages still available if not limited in contract
- *For Real Estate*: Claimant must be ready, willing and able to perform
- *For Real Estate*: Only for pre-closing damages
- *For Real Estate*: If warranty is breached, does purchaser want to compel sale?

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract Remedies 101: Remedies in Equity

Rescission

- Undo what was done
- Courts have unwound real estate contracts
- Can also obtain consequential damages with rescinded contracts
- Non-breaching party cannot continue to perform; Could waive rescission as remedy

Reformation

- Court rewrites contract to conform to the intent of the parties
- Mutual mistake; Fraud; Ambiguity
- *For Real Estate*: Issues with Letters of Intent

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract Remedies 101: Remedies in Equity

Injunctive Relief

- Court requires or prevents an action
- Rare, but allowed in real estate contracts—nonfungible—similar to specific performance
- Used to prevent sale of real estate
- Can preserve status quo until contract or property issues resolved
- Constructive trust on sales proceeds also available, but must show fraud or breach of a duty by the Seller

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract “Remedies” Specific to Real Estate

Record the Contract

- Very state-specific; Not allowed in all states (need a real property interest conveyed to purchaser at contract execution)
- Some states grant lien interest; some do not recognize as lien
- Is it prohibited in contract?
- Is the contract in recordable form?
- Shield as sword
- Slander of title risk

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Contract “Remedies” Specific to Real Estate

Lis Pendens/Notice of Pendency

- Record notice of lawsuit in property’s chain of title
- States vary for standard of applicability of lis pendens
- Need to file lawsuit
- In some states, not a substitute to a recorded contract
- Shield as sword
- Slander of title risk

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Default of Contract: General Issues

Notice of Default

- Is notice of default required
 - > Scrupulously comply with notice provisions; be specific if facts known
- In doubt, give notice to avoid waiver of rights; laches argument
- Confirm applicable cure periods
 - > Non-defaulting party's good faith could extend cure period

Right to Cure

- Confirm applicable cure periods
 - > Different periods for different defaults (e.g. monetary defaults 5 days; non-monetary defaults 30 day cure);
- Cure need only to remedy materiality of breach
- Seller should always have right to cure title issues



Default of Contract: General Issues

Is Breach Material?

- Contract language on materiality (e.g. seller's obligation to operate property prior to sale)

Obligations of Non-Breaching Party

- Non-breaching party must be performing and ready, willing and able to continue to perform
- Should not cease performance; Breach does not terminate contract—but does give non-breaching party right to terminate
- Duty to mitigate
- Continuing obligation of good faith and fair dealing
- Maintain “clean hands”

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Default of Contract: Specific Concerns

Pre-Closing vs. Post Closing Breach

- **Pre-Closing Breach**

- > Earnest money most likely remedy
- > Rescission/unwind of agreement easier
- > For Seller's breach, Buyer not stuck
- > Specific Performance available

- **Post-Closing Breach**

- > No earnest money or specific performance
- > Usually against Seller
- > Was escrow established for post-closing obligation?
- > If Seller was SPE, may have no alternatives

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Default of Contract: Specific Concerns

Warranty Breach

- **Innocent Breach**
 - > Buyer's right to cancel
 - > Failed condition of closing
 - > Damages post-closing?
- **Intentional Breach**
 - > Breach of contract triggering remedies
 - > Fraud
 - > If post-closing, is fraud only recourse?

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Default of Contract: Specific Concerns

Unable vs. Unwilling to Perform

- For some remedies, intent is irrelevant
- Willful breach could waive liquidated damages clause

Condition vs. Covenant

▪ **Unfulfilled Condition**

- > Normally not a breach
- > Conditions for both Buyer and Seller
- > Return parties to status quo—should be stated in contract
- > Must still perform in good faith and in fair dealing

▪ **Unperformed Covenant**

- > Breach of contract
- > Specific remedies in liquidated damages (specific performance?)

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: General Matters

Specific and Limited Remedies for Specific Defaults

- Pre-closing and post-closing remedies
- Specific remedies for warranty breach
- Keep right to perform if other party breaches (i.e. strategic breach)

Carve Out Consequential and Incidental Damages

- Eliminates potentially high damage amounts
- Include in liquidated damages section

Avoid Ambiguity

- Clauses limiting damages can be strictly construed
- Tremendous risk if remedies clause adjudicated ambiguous

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Earnest Money

How Much?

- Is there justification for a percentage of purchase price
- Get the Buyer's attention
- Presume single asset entity

Form of Earnest Money

- Cash is king
- Letter of Credit
 - > Negotiate terms
 - > Bank will not be arbiter of breach
 - > Is L/C appropriate (It's not a lease...)
- Promissory note?

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Earnest Money

Timing of the Deposits

- Multiple contingencies; Multiple deposits
 - > e.g. deposit after due diligence; deposit after land use approvals
- Buyer's payment of second deposit = Acceptance of the Property
 - > Eliminate Buyer's "conditional approvals" of due diligence

Escrow Agreement Terms

- Escrow Agreement separate from Contract
 - > Confirm terms of Contract override title co's form agreement
 - > Strike pro title company terms (e.g. use escrow funds for lawsuit)
 - > Single order before due diligence is complete (pro Buyer)

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Earnest Money

Escrow Agreement Terms (cont'd)

- Sales Contract as Escrow Agreement
 - > Expressly state escrow is joint order
 - > Opens door for issues with disposition of earnest money

Escrow Funds as Damages

- Customary Seller remedy
 - > For some states, case law requires total deposits due, not just paid
 - > Provides certainty for Buyer's legal remedy for Seller's breach
- Not necessarily precluded from equitable remedies
- In most states, return of earnest money is **not** adequate liquidated damages for Seller's breach (held to be illusory)

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Liquidated Damages

Liquidated Damages in General

- Specific Contract language
 - > Agreed upon damages are expressly stated
 - > Reasonable in light of a breach (agreed amount related to actual damages)
 - > Damages difficult or impossible to ascertain or quantify at the formation of the contract
 - > Agreed upon amounts are not a penalty or unreasonably high
- Many states are trending toward determining reasonableness at the time of contract formation and at the time of the breach
- Most states cannot choose multiple legal or equitable liquidated damages

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Liquidated Damages

Liquidated Damages in General (cont'd)

- Over-aggressive clauses may not be enforceable
 - > Too strong is a penalty; too weak is illusory
- Form, language and execution vary from state to state
 - > Some states require conspicuousness in contract (even in commercial)
 - > Some states require separate signature or initials

Legal and Equitable Liquidated Damages

- Can limit to only legal or only equitable damages *if expressly omit*
- Most states allow for one legal and one equitable agreed-upon remedy and the choice to pursue either
 - > States split on whether you can do both
 - > Liquidated damages is not choice of damages

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Liquidated Damages

Exceptions to Liquidated Damages

- Fraud
- Contest the formation of the Contract

Option Payment as “Liquidated Damages”

- Used by Sellers to avoid enforceability of amounts paid
- Label of “option payment” not enough for some courts to conclude liquidated damages
 - > Use separate option agreement giving optionee complete discretion to cancel and attach real estate contract to option agreement

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Liquidated Damages

Specific Issues with Liquidated Damages Clauses

- **Questions from the Buyer's Perspective**

- > Is earnest money too much; should buyer get equal amount
- > Are recoupment of out of pocket costs enough
- > In specific performance, does the buyer still want it
- > Are any remedies adequate post-closing

- **Questions from the Seller's Perspective**

- > Is the earnest money a "penalty"
- > Is specific performance necessary
- > Are post-closing remedies needed
- > Shouldn't the Seller get its carrying costs if not covered by earnest money

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Miscellaneous Provisions

Time Limit to Discover Warranty Issues

- Carve out “discovery rule” potential in some jurisdictions

Shorten Statute of Limitations

- Allowed in most states
- Stronger than discovery time limits; but not as well received by courts
- Shortening of S/L does not necessarily need to be mutual
- Must be “reasonable” and unambiguous; look to bargaining power
 - > e.g. 4 year statute of limitations reduced to 3 months held enforceable

Covenant Not to Sue

- Generally allowed so long as no fraud

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Limitation of Damages in the Contract: Miscellaneous Provisions

Right to Terminate

- May be implied, but if party wants right to terminate, should expressly include in contract
- Include language that termination of contract in event of a breach does not preclude remedies, liquidated damages or otherwise
- Exercise caution in terminating contract in event of a breach
 - > May preclude equitable remedies
 - > Gives breaching party repudiation argument

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Enforcing Remedies Against “Judgment Proof” Entities

Sellers as Single Asset, Single Purpose Entities

- The jargon: Special Purpose Entity (SPE); Single Asset Bankruptcy Remote Entity (SABRE); Single Asset Entity (SAE)—all essentially the same for purposes of enforcement
- Once SPE sells asset, Buyer may be S.O.L.
- Dealing with SPEs as Sellers
 - > Escrow or other security for post-closing obligations
 - > Corporate guaranty
 - > Provision requiring capitalization level of SPE post closing for period that Buyer can make a claim under contract
 - > Attempt to pierce veil for failing to capitalize entity for potential post-closing liabilities
 - > Buyer as SPE?

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

Current Market Issues in Negotiating Remedies

Troubled Assets

- Nothing left of the Seller's assets after selling the real estate
- What can Buyer's leverage get from SPEs in a Buyer's market

Buying OREO

- Limited remedies for purchaser as banks may not form SPEs for OREO
- Bank's time constraints or regulations may also preclude equitable remedies
- Banks generally risk averse
- Below market price offsets limited remedies?

R | S | P

ROBBINS, SALOMON & PATT, LTD.
Attorneys at Law

DISCLAIMER

This information and any presentation accompanying it (collectively the "Content") has been prepared by Larry N. Woodard of Robbins, Salomon & Patt, Ltd., an Illinois corporation (collectively "RSP") for general informational purposes only. It is not intended as and should not be regarded or relied upon as legal advice or opinion, or as a substitute for the advice of counsel. You should not rely on, take any action or fail to take any action based upon the Content.

As between RSP and you, RSP at all times owns and retains all right, title and interest in and to the Content. You may only use and copy the Content, or portions of the Content, for your personal, non-commercial use, provided that you place all copyright and any other notices applicable to such Content in a form and place that you believe complies with the requirements of the United States' Copyright and all other applicable law. Except as granted in the foregoing limited license with respect to the Content, you may not otherwise use, make available or disclose the Content, or portions of the Content, or mention RSP in connection with the Content, or portions of the Content, in any review, report, public announcement, transmission, presentation, distribution, republication or other similar communication, whether in whole or in part, without the express prior written consent of RSP in each instance.

This information or your use or reliance upon the Content does not establish a lawyer-client relationship between you and RSP. If you would like more information or specific advice of matters of interest to you please contact us directly.

© 2011 Robbins, Salomon & Patt, Ltd., All Rights Reserved.