PSA REMEDIES AND CLOSING CONDITIONS TRIGGERED BY BREACH

(Pre-Negotiated PSA Project)

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One of the ongoing projects of the Acquisitions Committee of the American College of Real Estate Lawyers (ACREL) is to develop a pre-negotiated purchase agreement in an effort to streamline the sale process for commercial real estate. Our Committee has reviewed and commented on almost thirty drafts of such a proposed "one size fits many" form,[1] attempting to find consensus among experienced practitioners in most areas of the U.S. as to the most balanced and logical approaches to the matters addressed in commercial real property purchase agreements. Among the more challenging aspects of this project has been determining the extent to which the purchase agreement should provide for remedies and closing conditions that are triggered by the other party's breach of the purchase agreement. This article will first consider general issues regarding (1) credit and (2) enforcement. It will then consider common drafting approaches and explain the drafting approach taken in the current draft (the "**Form**") of the pre-negotiated purchase agreement form as to the following: (3) a seller breach during the contract period (i.e., before closing or termination); (4) a buyer breach during the contract period; (5) closing conditions based on a breach; (6) survival; (7) post-termination remedies; and (8) post-closing remedies. This article will conclude with (9) a summary of some of the relevant provisions in the Form; and (10) a final note requesting input.

1. CREDIT ISSUES

Before embarking on the discussion of remedies, it may be helpful to consider what credit stands behind the obligations of the parties. More often than not, in the experience of the author, each party to a real estate purchase agreement is a special purpose entity (SPE) formed to own the property subject to the sale. If so, there may be a credit issue associated with each party when it does *not* own the property:

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[1] The Form makes a number of assumptions (e.g., regarding product type), which narrows its application, but Riders may be drafted to address alternative assumptions. Riders to address local issues and customs are also in the works for several jurisdictions. The Form is also subject to numerous disclaimers, which will not be repeated here other than to note that the Form is an amalgam of compromises which do not consistently reflect the views of any individual who assisted in the creation of the Form (and a buyer or seller may be unwilling to adopt all the positions adopted by the Form). The Form does provide a middle ground position for many, if not most, of the more commonly negotiated issues, which will hopefully expedite resolution and reduce, if not eliminate, unnecessary negotiation.

- the buyer credit issue is *before* the closing when the buyer's only asset may be the deposit;[2] and

- the seller credit issue is *after* the closing, when the seller's only asset may be whatever reserves it retains from the sale.[3]

Thus, when viewing the real estate sale transaction timeline, the parties' credit issues arise on opposite sides of the closing. This asymmetry may help explain some of the disparities in the Form's treatment of seller breaches *vs*. buyer breaches. While the Form does not eliminate the credit issues, it does contemplate (as will be discussed) greater access to buyer remedies before the closing (when the seller is more creditworthy because it owns the property) and greater access to seller remedies after the closing (when the buyer is more creditworthy because it owns the property). This approach may seem, at first blush, as illogical as searching for a lost item where there is more light. But there is some method to this lack of reciprocity, which will hopefully become clear by the end of this article.

1.1 **Seller Credit Enhancement**. The Form does not prescribe a single solution for the buyer's problem with the seller's credit after closing because many institutional real estate companies interviewed by the author had firm positions on this subject and they were far from uniform. Instead, the Form provides for alternative provisions to address this issue that the parties may choose for their transaction and tailor them to meet their needs.

1.1.1 Post-Closing Escrow. The Form includes an alternative for a post-closing escrow of a portion of the purchase price.[4] A holdback (where a portion of the purchase price is held back (i.e., retained) by the buyer, rather than deposited in escrow, until the relevant survival periods expire and any timely claims have been resolved) might be even better for the buyer, but is extremely rare in the author's experience and is not addressed in the Form.[5] Even a post-closing escrow is rare in the author's experience except in special circumstances (e.g., a

[2] *See, e.g.*, Robert E. Scher, *10 Tactical Omissions in a Commercial RE Buyer's Contract*, LAW360 REP. § 10 (Dec. 23, 2014) ("During the preliminary phase of negotiations, the seller typically deals with one or more individuals that are affiliated with a solvent entity. By the time the buyer's draft reaches the seller, however, the actual "buyer" may be an undercapitalized, single-purpose entity set up solely to acquire the property.").

[3] *See, e.g.*, Frederick L. Klein & Kevin L. Shepherd, *By the Way, What About the Post-Closing Credit Enhancement?*, 30 PROB. & PROP. J. 35 (May/June 2016).

[4] *See, e.g.*, GREGORY M. STEIN, MORTON P. FISHER, JR. & MICHAEL D. GOODWIN, A PRACTICAL GUIDE TO COMMERCIAL REAL ESTATE TRANSACTIONS: FROM CONTRACT TO CLOSING § 2.49 (ABA 3d ed. 2016) ("If the seller plans to distribute the sale proceeds to its equity holders and dissolve promptly after closing, then . . . the buyer may ask the seller to leave some portion of the sales proceeds in escrow . . . .").

[5] Holdbacks are common in the context of earn-outs for the portion of the purchase price that is contingent upon achieving the earn-out requirements. But such a holdback is very different than one to secure the seller's post-closing obligations.

temporary leaseback to the seller,[6] an unresolved issue at closing,[7] uncompleted construction work that is not credited at closing,[8] or a sale of ownership interests by multiple sellers). It is also possible to provide a letter of credit or other security in lieu of escrowed cash, but these solutions are unusual in the author's experience, generally require more elaborate provisions, and are not addressed in the Form.

1.1.2 Guaranty. Another alternative in the Form is a guaranty of the seller's post-closing obligations from a creditworthy affiliate (or at least more creditworthy than the seller will be after it distributes sale proceeds to its owners), which is included in an optional joinder to the purchase agreement.[9] This solution seems to be a favorite among many of the attorneys interviewed by the author. But some sellers simply refuse to provide such affiliate guaranties, so our Committee was unable to reach agreement on this solution.

1.1.3 Net Worth/Reserves. Some purchase agreements obligate (and the Form includes alternative language requiring) the seller to maintain for a period of time after closing a certain net worth or reserves or both.[10] Sometimes the purchase agreement simply obligates the seller to maintain sufficient assets to meet its obligations until the expiration of the relevant survival periods.[11] It is not clear how useful these financial obligations are if they are not guaranteed. Perhaps a breach of such an obligation makes it is easier to trace distributions (and even establish a fraudulent transfer) and could give rise to a claim for promissory fraud. However, some sellers resist such obligations. For example, some sellers want to maximize distributions to stop preferred returns from accruing to investors; reserves (and net worth requirements) conflict with that goal.[12]

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[6] *See, e.g.*, 14 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 81.04[2][d], at 81-187–81-188 (Michael A. Wolf ed., 2000; 2020), § 81.03[4], at 81-108 ("A portion of the purchase price can be held in escrow at the time of the closing as security for payment of any charges that may become due because seller retains possession.").

[7] *See, e.g.*, CALIFORNIA CEB, REAL PROPERTY SALES TRANSACTIONS § 15.96, at 15-77 (4th ed. 2020) (the "**CALIFORNIA CEB SALES BOOK**") ("Sometimes, parties to an escrow have issues that remain unresolved at closing . . . that make the parties want the escrow holder to hold funds . . . until the dispute is resolved.").

[8] *See, e.g.*, 1 ALVIN L. ARNOLD & MYRON KOVE, MODERN REAL ESTATE PRACTICE FORMS AND COMMENTARY, § 8:2 [short form PSA for complex commercial transactions], § 13.5 at 8-17 ("[I]f Seller commences restoration [of casualty damage] and it is not timely completed, Seller shall place in escrow with the Escrow Agent or such other escrow agent acceptable to Purchaser, the unpaid cost of completion, which amount shall be paid over to the contractor doing the restoration in accordance with the restoration contract."); STEIN, *supra*, § 7.21 (The Walk Through and Post-Closing Agreement).

[9] *See, e.g.*, STEIN, *supra*, § 2.49 ("Or a creditworthy affiliate of the seller may guarantee the seller's post-closing liability, subject to the cap, floor, and survival period limitations just noted.").

[10] *See, e.g.*, STEIN, *supra*, § 2.49 ("The seller may agree to maintain a specific net worth, usually tracking the amount of the liability cap, for the survival period.").

[11] *See, e.g.*, 2 STUART M. SAFT, COMMERCIAL REAL ESTATE FORMS § 9:30 [Multifamily PSA] (3d ed. 2019), § 11.16.1 at 9-212.21 ("Seller covenants that it shall maintain sufficient assets to fulfill any obligation or liability to Purchaser under this Agreement. [This] covenant . . . shall survive Closing until the expiration of the Survival Period, except to the extent that a claim against Seller is filed by Purchaser prior to the expiration of the Survival Period, in which case such covenant shall survive until such claim is resolved.").

[12] The concerns in this example are also present for the escrow (or holdback) solution discussed 1.1.1, but if they can be overcome, the seller would presumably favor the net worth or reserve solution because it would have

1.1.4 Chasing Distributions. The Form includes alternative language that acknowledges the tracing rules under the applicable limited liability company or limited partnership act (which may permit the buyer to reach distributions made to the seller's investors).[13] The primary reason this alternative is adopted is that the buyer may not care or has little choice:

> Buyers often attempt to negotiate escrows, holdbacks, guarantees, letters of credit and other forms of security for a seller's post-closing liabilities, . . . Sellers typically resist these arrangements . . . . In a robust sales market, buyers often have to live without such security.[14]

The tracing remedy is easier to accept if the seller is wholly-owned (directly or indirectly) by a single entity with meaningful net worth in addition to its interest in the seller. Otherwise, some buyers may be troubled that this remedy is too difficult to enforce because of the number of parties involved and any knowledge requirement (i.e., any requirement that the distributee had knowledge that the seller failed to retain adequate reserves at the time of distribution).[15] Some buyers are also worried about procedural issues because the liability of a distributee to return a wrongful distribution may run in favor of the entity rather than its creditors.[16] Nonetheless, some buyers believe that the risk of violating the relevant statutes, together with the reputational risk (associated with failing to honor one's obligations), provide sufficient comfort that the seller will honor its obligations.

1.1.5 R&W Insurance. Finally, there are alternative provisions contemplating representation and warranty insurance. While common in corporate acquisitions,[17] such insurance is rarely obtained, in the author's experience, in real estate sales. The objection

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greater control over the amounts involved. On the other hand, if the seller is owned by a fund, private REIT or other entity that is disposing of its last investment, it may prefer a reserve (or even an escrow) to avoid the need to get money back from its investors if funds are required to satisfy a post-closing claim.

[13] *See, e.g.*, 6 Del. Code §§ 18-607, 18-804 (2020) for Delaware limited liability companies and 6 Del. Code §§ 17-607, 17-804 (2020) for Delaware limited partnerships.

[14] Mitchell Berg & Peter Fisch, *Recovery of Non-Permitted Distributions*, 250 N.Y. L.J., No. 113 (Dec. 11, 2013). One may question whether this solution is different than remaining silent. Perhaps not. But it might have some estoppel effect if the tracing right were litigated. And there may be some psychological benefit in having an explicit understanding that there is some remedy available if the seller has no assets to pursue (other than its right to claw back improper distributions).

[15] *See, e.g.*, 6 Del. Code § 18-607(b) ("A member who receives a distribution in violation of subsection (a) of this section, and *who knew at the time of the distribution* that the distribution violated subsection (a) of this section, shall be liable to a limited liability company for the amount of the distribution." (emphasis added)).

[16] *See, e.g.*, 6 Del. Code § 18-607(b) ("A member who receives a distribution in violation of subsection (a) of this section, and who knew at the time of the distribution that the distribution violated subsection (a) of this section, *shall be liable to a limited liability company* for the amount of the distribution." (emphasis added)). *But see, e.g.*, 6 Del. Code § 18-805 (which allows creditors under certain circumstances to get a receiver or trustee to collect the debts of the limited liability company).

[17] *See, e.g.*, Jeffrey Chapman, Jonathan Whalen & Benjamin Bodurian, *Representations and Warranties Insurance in M&A Transactions*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Dec. 11, 2017); 2 LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS, § 15.07 at 15-51–15-54.

encountered by the author is that the parties don't want to spend the time and money for all but the larger, more complicated deals, where there is no other acceptable solution. And when representation and warranty insurance is purchased for a real estate transaction, there is a sometimes a steep learning curve as the uninitiated real estate lawyer comes to terms with the policy forms and procedures involved. Perhaps if such insurance were widely used, it might become sufficiently less expensive to expediently solve the post-closing credit issue on a uniform basis.

1.2 **Buyer Credit**. Unlike the seller, that might be a complete shell *after closing* (when it doesn't own the property), the buyer typically has at least one asset *before closing* (when it doesn't own the property), namely, the deposit. The Form allows the seller to cancel the purchase agreement, and take the deposit, for only two of the most fundamental breaches – a material breach of the buyer's obligation to close (which will be referred to as the buyer's "wrongful failure to close") or the failure (after notice and an opportunity to cure) to fund an additional deposit. It is theoretically possible to use (and some practitioners have suggested using) portions of the deposit to cover other breaches (whether as collateral or payment). But that approach is uncommon in the author's experience. Like most contracts reviewed by the author, the Form does not provide for any credit enhancement to address the buyer credit issue. Many sellers take comfort from the fact that the buyer credit risk is limited by the seller's agreement to look solely to the deposit in case of the most material breach (i.e., the wrongful failure to close), the fact that this credit risk is assumed by many other sellers, and from the following mitigating factors:

1.2.1 Termination. The buyer credit issue generally arises under the Form only if the purchase agreement terminates (because liability for the buyer's other obligations generally survives closing and the buyer will own the property after closing). Termination may occur in a number of ways. Perhaps the most problematic termination is by the seller due to a buyer breach; but the Form limits this right to only two breaches, each of which triggers liquidated damages (as discussed earlier). Consequently, the possibility that there is a dispute regarding the collection of the deposit, or a claim by the seller for actual damages (because the liquidated damages clause is invalid), or a claim by the seller for attorneys' fees (in connection with either) is reduced: if the liquidated damages clause is limited in its application, then there is less opportunity to fight over it[18]. Termination by the buyer due to a seller breach is under the seller's control (and, in that event, there is the possibility of a counterclaim). The other termination rights (i.e., those not triggered by a breach) in the Form are for:

- title problems seller is unwilling to cure;
- inadequate tenant estoppels;

[18] It may seem odd to suggest that the seller should take comfort that the Form limits its ability to terminate the purchase agreement. Admittedly, the seller may not be happy about limiting its termination rights. But this approach does take some pressure off the buyer credit issue (because the Form also provides that liability for the buyer's contract period breach survives the closing so that the seller may have recourse at a time when the buyer will likely have better credit).

- a material inaccuracy in a party's representations and warranties as of closing (that does not constitute a breach);
- a major casualty or condemnation; and
- any reason during due diligence.

In the author's experience: termination by reason of title, tenant estoppels, an inaccuracy in a party's down-dated representations, or casualty/condemnation is rare. The most commonly exercised termination right is the right to terminate during due diligence, which is often if not usually completely unlimited. On the other hand, the due diligence termination right is generally not available after the due diligence period, so there is less time for a claim against the buyer to accrue.

1.2.2 Limited Potential Claims. In order for the buyer's credit to be an issue, not only must the purchase agreement be terminated, there must also be a claim against the buyer. Aside from the buyer obligations that may trigger loss of the deposit, there is often little more in the way of buyer pre-closing obligations:

- minimal representations;
- indemnifications regarding due diligence activities and broker's claims;
- other due diligence obligations (e.g., not to disturb tenants);
- confidentiality obligations; and
- the obligation to pay attorneys' fees if the seller prevails.

The obligation to pay attorney's fees is likely the most troubling of these potential claims, but it does not arise unless there is a dispute. And the other potential obligations rarely get the seller's attention when dealing with a reputable buyer (other than the buyer's due diligence indemnity, as discussed next).

1.2.3 Insurance. The Form requires insurance in connection with the buyer's due diligence activities, which provides some comfort in the case of the due diligence indemnity.

1.2.4 Reputation; Seller's Position on Post-Closing Credit. To many sellers, the most important factor is the reputation of the buyer. The conventional wisdom seems to be that a reputable buyer (and this is an underlying assumption of the Form) will likely honor its obligations to protect its reputation. Also, if the seller is refusing to provide much in the way of post-closing credit enhancement, it may be hard pressed to demand pre-closing credit enhancement from the buyer.

2. ENFORCEMENT ISSUES

The credit of the other party may be little comfort to the extent that the remedy sought to be enforced against that party is limited by law or the terms of the purchase agreement. Enforcement issues may arise not only when enforcing contractual remedies, but also when enforcing contractual limits on (or enhancements of) remedies. Some of the more common enforcement issues that have served as guideposts in creating the Form are discussed next.

2.1 **Liquidated Damages**. Liquidated damages are commonly viewed as the primary remedy for the seller in a real estate purchase agreement.

> One reason for the popularity of the liquidated damages remedy is that it is capable of enforcement by self-help execution. Without resorting to the courts and without conforming to any preliminary procedural requirements, the seller may simply respond to the purchaser's breach by retaining the purchaser's down payment as the liquidated damages set by the parties' contract.[19]

However, in the typical purchase agreement encountered by the author, the deposit is held by a third party escrow agent; and therefore the forfeiture of the deposit may not be immediate. Moreover, even liquidated damages clauses can end up in court.

2.1.1 Reasonable? The key requirement for a valid liquidated damages clause is reasonableness.[20] And reasonableness may be challenged in a number of ways (aside from simply asserting that the liquidated amount is excessively large):

- *Shotgun Clauses*. If the liquidated damages provision applies to *any breach* of the buyer (or a variety of breaches of differing magnitude), it is sometimes called a *shotgun* clause. It may be hard to believe that a buyer would consciously agree to forfeit its deposit for *any breach whatsoever* (assuming it had a choice). Such a forfeiture could result in a loss to the buyer that has no reasonable relationship to the actual loss incurred by the seller as a result of the breach. Not surprisingly, such a clause may be unenforceable for this very reason: it may not be a reasonable estimate of the damage (especially if reasonableness is tested at the time of the contract, when the magnitude of a future breach is not known).[21]

- *Exceeding Statutory Safe Harbor*. In states with safe harbor statutes, exceeding the statutory limit may be dangerous. For example, in Oklahoma, if the safe harbor (5% of the purchase price) is exceeded, the provision is

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[19] 14 POWELL, *supra*, § 81.04[2][d], at 81-187–81-188 (footnote omitted).

[20] *See* Stevens A. Carey, *Liquidated Damages in a Real Estate PSA: A Closer Look*, 35 PRAC. REAL EST. LAW. 24, § 6 at 39 (Jan. 2019) [hereinafter, the "**Carey Liquidated Damages Article**"].

[21] *See* Carey Liquidated Damages Article, *supra*, § 12 at 44-45.

presumed to be invalid unless the party seeking to uphold the provision establishes that the amount is reasonable.[22]

- *Burden of Proof*. In some of the jurisdictions without safe harbor statutes, the seller has the burden of proof to establish reasonableness.[23] In such jurisdictions, a prudent seller will not tempt fate with an excessively broad liquidated damage clause or an excessively large liquidated damage amount.

Partially in response to the *shotgun* issue, the Form limits the seller's right to the deposit, as liquidated damages, to only two breaches: (1) the buyer's wrongful failure to close, and (2) if the deposit is comprised of an initial deposit and an additional deposit, the buyer's failure to deposit the additional deposit after notice and a cure period (and in the latter circumstance, the liquidated damages are limited to the initial deposit). But the Form leaves it to the parties to specify the amounts of the initial deposit and any additional deposit.

2.1.2 Optional? If the seller has the option of choosing *liquidated* damages or *actual* damages, then one can argue that the parties have not made much of an attempt (and did not actually intend) to liquidate damages. And that argument has prevailed in some jurisdictions (e.g., Illinois and Florida) where *optional liquidated damages* have been found to be unenforceable.[24] The Form does not allow for an *actual damage* remedy alternative to liquidated damages for the two defaults identified (i.e., wrongful failure to close or to post the additional deposit) so there is no issue of *optional liquidated damages*.

2.1.3 Exclusive? Buyers also like liquidated damages, when they can make them an *exclusive* remedy, because they may be able to walk from a deal with capped exposure. However, not all purchase agreements provide that liquidated damages are an *exclusive* remedy. And the mere presence of a liquidated damages clause does not necessarily preclude specific performance by the seller,[25] which might prevent the buyer from walking at all. In the absence of clear exclusivity, courts may glean the intent of the parties from the wording of the purchase agreement. As noted in 4.2 below, a cancellation and liquidated damages remedy may sometimes appear to use mandatory language (e.g., the contract *shall be* cancelled and the deposit *shall be* retained as liquidated damages). Whether such purported mandatory language is sufficient to establish an exclusive remedy may depend on the facts and the jurisdiction.[26] The Form makes cancellation of the purchase agreement and the right to the deposit as

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[22] 15 OKLA. STAT. § 15-215(B) (2018); compare the statute in Washington under which common law principles apply if the safe harbor is exceeded. WASH. REV. CODE ANN. § 64.04.005 (2018). However, it appears that the result would be similar because Washington case law places the burden on the non-breaching party to establish the reasonableness of a liquidated damages provision. Gary Fluhrer, Scott Osborne & Michelle Rusk, *Liquidated Damages in Washington State Real Estate Purchase and Sale Agreements*, 35 PRAC. REAL EST. LAW. 29 at 30 (Sept. 2019).

[23] *See, e.g.*, Carey Liquidated Damages Article, *supra*, § 7.

[24] *See, e.g.*, Carey Liquidated Damages Article, *supra*, § 2.

[25] *See, e.g.*, Carey Liquidated Damages Article, *supra*, § 1; *see also, id*, § 2 for discussion of the possibility of any *actual damage* alternative in some jurisdictions depending on the wording, as discussed below.

[26] *See, e.g.*, Carey Liquidated Damages Article, *supra*, § 1.3.

liquidated damages the *sole* (i.e., *exclusive*) remedy for the two defaults identified.[27] But the Form does not limit the seller's remedies for other breaches so there is a possibility, at least in theory, that the seller could terminate the purchase agreement for a different material breach (without a contractual right to obtain the deposit).[28]

2.2 **Illusory Contracts?** If a contract may be viewed as imposing meaningful obligations upon one party but not the other party, then there may be no consideration to support the promises of the obligated party and the contract might be viewed as illusory and not enforced as written. This issue has arisen in at least two different ways in real estate purchase agreements.

2.2.1 Unilateral Termination Rights. Some purchase agreements give one of the parties an unfettered right to terminate the agreement (with no liability) during certain periods or a right to terminate subject to conditions that are within the control of the terminating party. In particular, it is very common for a purchase agreement to include a so-called *free look*: the buyer may terminate the purchase agreement for any reason or no reason during the due diligence period. Such termination rights have been held on occasion to create an *illusory* contract.[29] While this problem might be curable (e.g., through part performance), it may be relatively easy to avoid at the outset: the Form provides that a portion of the deposit equal to $100 constitutes independent consideration that eventually goes to the seller no matter what happens to the sale. The Form does not include any other termination rights that would create this problem.

2.2.2 No Meaningful Buyer Remedies. Some sellers refuse to give the buyer *any remedy* other than cancellation of the purchase agreement and a refund of the deposit. Although this position is rare, the author has encountered this approach from time to time, particularly in the context of sales of so-called "REO" assets by banks. One may wonder whether such a limitation is illusory (or otherwise enforceable).[30] As written, the seller may not

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[27] The amount of the Deposit is different in these two circumstances (i.e., (1) the wrongful failure to close and (2) the failure to fund the Additional Deposit after notice and cure). In the Form, the Deposit is defined to be the Initial Deposit, and to the extent delivered, the Additional Deposit (together with all interest earned). Thus, the Deposit that is forfeited when the Additional Deposit is not funded (after notice and cure) is limited to the Initial Deposit (and interest on the Initial Deposit).

[28] *See, e.g.*, 2 JOSEPH M. PERILLO, CORBIN ON CONTRACTS (1995; 2020) § 6.15 at 319 ("By operation of law a party may cancel a contract if the other party materially breaches the contract."). But query whether a buyer breach other than the wrongful failure to close would be sufficient to allow the seller to cancel the purchase agreement by operation of law? *See, e.g.*, 13 CORBIN ON CONTRACTS, *supra*, § 68.2(2) at 169 ("If one party to a bilateral contract commits a partial breach of its duty, one that is not a total breach, the injured party's only remedy is damages for the partial breach." (footnote omitted)

[29] *See, e.g.*, Stevens A. Carey, John R. Cauble & Richard H. MacCracken, *The "Free Look" in California—You Get What You Pay For*, 33 REAL PROP. L. REP. 89 (July 2010). *But see* 2 CORBIN ON CONTRACTS, *supra*, § 5:32 at 175-176 ("It has been thought, also, that promissory words are illusory if they are conditional on some fact or event that is wholly under the promisor's control . . . . This is not true, however, if the words used do not leave an unlimited option . . ."), § 6.10 at 291-293 ("At . . . times statutes and judge-crafted law have put limitations on the power of termination. Where such limitations exist, the presence of consideration is crystal clear. In some cases, the court seems to have thought the reservation of a power to terminate in one party is substantially the same as if that party had made an illusory promise. In most cases, however, it is far otherwise . . .").

[30] *See, e.g.*, *IDEVCO, Inc. v. Hobaugh*, 571 So. 2d 488 (Fla. Dist. Ct. App. 1990); *Hackett v. J.R.L Dev., Inc.*, 566 So. 2d 601 (Fla. Dist. Ct. App. 1990); and *Ocean Dunes v. Colangelo*, 463 So. 2d 437 (Fla. Dist. Ct. App. 1985).

be required either to honor the contract or to pay damages if it chooses not to do so. Is that a meaningful obligation? Once the transaction is closed, this concern is presumably no longer an issue. But in some jurisdictions (e.g., Florida) prior to closing (or to a cure of the problem by, for example, part performance), might such a clause lead to unintended consequences?

- *Limiting Seller's Remedies*. Might the seller be unable to exercise its remedies (and the buyer be able to require a refund of its deposit) after the buyer wrongfully fails to close (because the default provisions are held to be void)?[31]

- *Expanding Buyer's Remedies*. Might the limitation on the buyer's remedies be disregarded because of the illusory nature of the seller's obligations (so that, for example, an action by the buyer for specific performance is allowed)?[32]

If enforced as written, the seller might be able to breach "with absolutely no harmful consequences."[33] Indeed, the buyer would not be able to specifically enforce the agreement, and "return of one's own money hardly constitutes damages in any meaningful sense."[34] Although this issue may not arise in many jurisdictions,[35] why take the chance that a court might

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But see Debra Pogrund Stark, Jessica M. Choplin & Eileen Linnabery, *Dysfunctional Contracts and the Laws and Practices That Enable Them: An Empirical Analysis*, 46 IND. L. REV. 797 (2013) ("Courts in jurisdictions outside of Florida have refused to strike down this type of liability limiting clause . . . ."), and *Victory Christian World Ministries, Inc. v. MJP Distrib. LLC*, 199 So. 3d 1035 (Fla. Dist. Ct. App. 2016) (allowed a seller to enforce a contract that limited the buyer's remedies to cancellation and a return of the deposit because the seller "cured" the defects of the limited remedy clause by being ready, willing and able to proceed). Compare the following comments to Uniform Commercial Code (UCC) Section 2-719: "However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. . . . Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article." Although the UCC does not apply to the sale of real estate, a buyer might attempt to influence a court with the UCC's reasoning. At least one buyer tried unsuccessfully to do so in a case involving a limitation of the buyer's remedies to a return of the deposit. *Torgerson v. One Lincoln Tower, L.L.C.*, 210 P.3d 318, 324-25 (Wash. 2009).

[31] *See, e.g.*, *IDEVCO*, *supra* (however, the seller was allowed to deduct from the deposit the security deposit and last month's rent according to a lease by the buyer, which provided for such deduction in the event the buyer failed to close under the purchase agreement).

[32] *See, e.g.*, *Ocean Dunes*, *supra*.

[33] *See Ocean Dunes*, *supra*, at 439.

[34] *See id*.

[35] *See, e.g.*, Stark, *supra*. However, in many of the cases cited by Stark (as support for the notion that such clauses may be enforceable), there are facts or *dicta* suggesting that the issue is not free from doubt. *See, e.g.*, *Tanglewood Land Co. v. Byrd*, 256 S.E.2d 270, 271 (N.C. Ct. App. 1979) cited in Stark at n. 6 (the court held that the purchase contract was not illusory because the buyer had meaningful remedies under Virginia law despite the limited remedy clause, saying that "insofar as paragraph 6 attempts to limit the liability of the vendor for breach of the contract under any circumstances to return of the payments made, it is contrary to the settled law of Virginia and inoperative"); *Tanglewood* was upheld on appeal in a split decision (with the dissent finding an illusory contract and the majority stating that if the seller "has acted in bad faith in originally undertaking to convey title, or has voluntarily disabled itself from such a conveyance … it will be liable to the purchasers … for their loss of bargain.") *Tanglewood Land*

conclude (or that the seller might need to go to court to rebut the argument) that the contract should not be enforced as written because "the seller has no real obligation and can breach the contract with impunity"[36] or "the seller's obligations are wholly illusory."[37]

In a balanced contract, such provisions rarely surface. Not surprisingly, there is no such issue in the Form: if the buyer cancels the purchase agreement due to a material seller breach, the buyer is entitled to reimbursement of out-of-pocket costs in connection with the sale up to a cap; moreover, the buyer has the alternative right to seek specific performance.

2.3 **When Seller Makes Specific Performance Impossible**. As discussed later, most seller form purchase agreements reviewed by the author give the buyer the right to specifically enforce the purchase agreement (as an alternative to terminating and getting a refund of the deposit). But what if the seller takes action that deprives the buyer of the right to specifically enforce the contract because, for example, it has conveyed or encumbered the property? At least in some jurisdictions (e.g., Florida), such a seller may effectively undo a contractual limitation precluding damages.[38] However, even in Florida, courts may be reluctant to override a limitation of remedies agreed to by the parties when the aggrieved party has an available (albeit limited) remedy under the contract.[39] One may wonder what a court would do with a contract between sophisticated parties that precludes damages other than reimbursement of costs up to a cap. What if the seller were to sell to another party at a profit and argue that it bargained for the right to do so? A buyer would likely counter that its right to specifically enforce the contract was intended to be optional at the election of the *buyer* (as an alternative to cancellation of the purchase agreement) – not the *seller*. Indeed, the buyer would likely continue, it bargained for a right to specifically

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Co. v. Byrd, 261 S.E.2d 655, 657, 660 (N.C. 1980); Markowitz v. Ne. Land Co., 906 F.2d 100, 102-10 (3d Cir. 1990) (buyer didn't attempt to invalidate the clause; it was the seller/developer who was making the argument that the buyer had additional remedies in an unsuccessful attempt to avoid application of the Interstate Land Sales Full Disclosure Act; the court found that the homeowner buyer had a viable claim because the contract was so limited and Pennsylvania law permits such a limitation when the contract is clear, without citing any support for that conclusion except a possible suggestion that a liquidated damages analysis applied.); and the issue of an illusory contract was not timely raised or raised at all in many, if not most, of the cases cited by Stark, *supra*. *See, e.g.*, *Simpson Dev. Corp. v. Herrmann*, 583 A.2d 90 (Vt. 1990) cited in Stark, *supra*, at n. 101 ("Arguably, the limitation clause lacked 'mutuality,' and therefore [the buyer] should not be bound by it . . . . However, [the buyer] neither presented this theory at trial nor on appeal." (citation omitted)) and Stark, *supra*, at n. 103.

[36] Hackett, *supra*, at 603.

[37] *Ocean Dunes*, *supra*, at 439.

[38] *See, e.g.*, *Schachter v. Krzynowek*, 958 So. 2d 1061, 1065 (Fla. Dist. Ct. App. 2007) ("The policy . . . that '[a] seller will not be permitted to profit from his breach . . . when the breach is followed by a sale of the land to a subsequent purchaser' … trumps the application of the limitation of remedies clause."); *Seaside Cmty. Dev. Corp. v. Edwards*, 573 So. 2d 142 (Fla. Dist. Ct. App. 1991) (a clause limiting a buyer to specific performance or a refund of deposit did not preclude recovery of damages where the seller's sale of the property to another deprived the buyer of specific performance); *Kooloian v. Suburban Land Co.*, 873 A.2d 95, 99 (R.I. 2005) (". . . we can hardly envision a clearer case of fraud – contracting to sell property that a party had already sold to someone else. . . .In this case, the [sellers] acted in bad faith and committed fraud, thus entitling [buyer] to damages beyond a refund of the deposit.").

[39] *See, e.g.*, *In re Tousa, Inc.*, 503 B.R. 499, 503 (Bankr. S.D. Fla. 2014) (which distinguished *Schachter* because there was no resale at a profit, the contract allowed for "all rights and remedies available to Buyer in equity, including . . . specific performance," and the buyer had an opportunity to object to the resale, which was conducted by court order, and concluded that the remedy limitation that precluded a damage recovery was neither unconscionable nor illusory).

enforce the contract and the seller deprived it of the benefit of its bargain. In other words, the buyer may argue that the limitation on the buyer's damage remedy (i.e., capped reimbursement) was not intended to apply to an intentional evasion of the buyer's specific performance remedy. The seller may then counter that the buyer is trying to rewrite the contract; if an exception to the remedies limitation were intended, it would have been included in the contract.[40] Unfortunately, if the seller breaches its obligation to close, it may not always be clear how a court would resolve the apparent conflict between parties' intent (x) to give the buyer a specific performance remedy, on the one hand, and (y) to limit the damages recoverable by the buyer, on the other hand. It may come down to whether the seller's transfer is viewed as willful misconduct rather than merely an intentional breach to further its economic self-interest. The buyer may, of course, be in a stronger position if it also has a tort claim.

2.4 **Indemnities**. Much has been written about enforceability issues with indemnities in the construction context (by reason of so-called *anti-indemnity statutes*).[41] Even outside the construction context, indemnities may face challenges, and in particular be narrowly construed. For example, in California, it has been said that "to be indemnified for one's own active negligence, or regardless of the indemnitor's fault, the contractual language 'must be particularly clear and explicit . . . .'"[42] There are four indemnities in the Form (for due diligence activities, letter of credit security deposits, broker claims, and tax free exchanges). Three of these indemnities have a relatively narrow and specific focus: the exchange indemnity is relevant only when one of the parties is completing an exchange; the letter of credit security deposit indemnity is relevant only when a security deposit is in the form of a letter of credit (and only if the buyer wants to draw upon the letter of credit before it is transferred, or replaced with a letter of credit issued, to the buyer); and the broker indemnity is relevant only when there appears to be a misunderstanding with a broker. But the due diligence indemnity from the buyer has potential application in most deals, is not necessarily tied to the buyer's fault, and is often the source of negotiation: many sellers want complete indemnifications, but many buyers want to carve out the seller's negligence and willful misconduct (in addition to the mere discovery of existing conditions). As a

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[40] *See, e.g., Goodwin v. Hole No. 4, LLC*, No. 2:06-cv-00679, 2007 U.S. Dist. LEXIS 56271 (D. Utah July 31, 2007) (in which the buyer unsuccessfully argued that the contractual limitation on it remedies to a refund of the deposit plus 10% interest should be limited to *unintentional* defaults); *Electron Trading, LLC v Morgan Stanley & Co. LLC* 157 A.D.3d 579, 581 (2018) ("a party can intentionally breach a contract to advance a 'legitimate economic self-interest' and still rely on the contractual limitation provision.").

[41] *See, e.g.*, Allen Holt Gwyn & Paul E. Davis, *Fifty-State Survey of Anti-Indemnity Statutes and Related Case Law*, 23 CONSTRUCTION LAW. 26 (Summer 2003); Gregory Podolak, *Contractual Insurance Requirements and Anti-Indemnity Statutes*, IRMI (July 2016).

[42] 1 CALIFORNIA CEB, REAL PROPERTY REMEDIES AND DAMAGES § 3.89A, at 3-109 (2d ed. 2019) (although the case it cites for this statement is a construction case); *see also*, Rooz v. Kimmel, 55 Cal.App. 4th 577, 583 (1997), a non-construction case, which stated, in dicta, "An indemnity agreement may provide for indemnification against an indemnitee's own negligence, but such an agreement must be clear and explicit and is strictly construed against the indemnitee"; 2 KLING & NUGENT, *supra*, § 15.02[2] at 15-19 (referring to "the apparent general tendency to find against parties seeking indemnification"); 1 MARK A. SENN, COMMERCIAL REAL ESTATE TRANSACTIONS HANDBOOK, (4th ed. supp. 2020) § 5.04[B][4] at 5-20—5-21 ("As a final matter, with respect to any indemnities in the PSA, the law contains many potential pitfalls that should be considered in the drafting of the relevant provisions . . . . The language of the indemnity must be: clear, unequivocal, and certain . . . . The indemnity provisions of a contract will be construed narrowly against the drafter and the burden of proving a right to indemnification rests with the indemnitee." (footnotes omitted))

compromise, the Form due diligence indemnity covers the seller's negligence (specifically mentioning *sole* and *active* negligence) but only to the extent it would be covered by the insurance required to be carried by the buyer under the Form.

2.5 **Limiting Liability to Purchase Agreement Obligations**. The parties, particularly sellers, often take many steps to limit their obligations to the four corners of the purchase agreement. In the corporate acquisition context, where this issue seems to have received the most attention, these steps include requiring one or more of the following clauses in the purchase agreement:[43]

- Exclusive Remedy Clauses;[44]
- Integration/Merger Clauses;[45]
- Disclaimers of other promises;[46] and
- Non-reliance clauses (as to other promises).[47]

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[43] *See, e.g.*, Glenn D. West & W. Benton Lewis, Jr., *Contracting to Avoid Extra-Contractual Liability – Can Your Contractual Deal Ever Really Be the "Entire" Deal*, 64 BUS. LAW. 999 (2009); Winston & Strawn LLP, *The Looming Specter: Post-Closing Fraud Claims in Private Company M&A Litigation*, PRIVATE EQUITY UPDATE (June 22, 2017).

[44] Corporate acquisition agreements may provide that indemnification rights in the purchase agreement are the exclusive remedies for a breach of the purchase agreement. *See, e.g.*, 2 KLING & NUGENT, *supra*, § 15.02[4] at 15-30.4–15-30.11 9:30; West & Lewis, Jr., *supra*, at 1020 ("[C]ontracting parties . . . include indemnification and exclusive remedy provisions to limit their liability for representations and warranties set forth in the written contract itself. And if drafted broadly to cover actions arising in both contract and tort, an exclusive remedy provision can help protect a contracting party from extra-contractual liability in jurisdictions that permit transacting parties to premise fraud claims on the basis of contractual representations and warranties." (footnotes omitted)).

[45] *See, e.g.*, 2 KLING & NUGENT, *supra*, § 25.02[4], n 53.1 at 15-30.5 (". . . a standard integration clause ('this agreement, together with the schedules hereto and certificates required hereby, and the confidentiality agreement, constitute the entire agreement between the parties')."); JEFF C. DODD, DRAFTING EFFECTIVE CONTRACTS: A PRACTITIONER'S GUIDE (3d ed. 2020) § 2.11[B][1][a] at 2-96—2-97 ("The purpose of this [clause] is to establish an agreement that the contract is complete . . . this is done to convince a court that the parties really mean that the written word is not only sacred, but exclusive. Nevertheless, the effectiveness of a merger clause to preclude the showing of additional oral terms or conditions will vary from jurisdiction to jurisdiction, even when the clause . . . very specifically negates the existence of other terms and conditions."). As explained later in this 2.5, an *integration clause* is also known as a *merger clause*. Not surprisingly, an integration clause may not eliminate tort claims, such as fraud. West & Lewis, Jr., *supra*, at 1026 provide an illuminating quote from Judge Posner of the 7th Circuit: "fraud is a tort, and the parol evidence rule is not a doctrine of tort law and so an integration clause does not bar a claim of fraud based on statements not contained in the contract."

[46] Disclaimers (of other representations) are arguably a type of (or may be included within a) merger clause. But they may appear more clearly intended to eliminate not only contract, but also tort, claims regarding representations, by disclaiming the existence of any representations other than those in the purchase agreement. *See, e.g.*, 7 CORBIN ON CONTRACTS, *supra*, § 28.21 at 28 ("[A] merger clause may not be entirely ineffective. If the clause states that no representations have been made . . . the clause, although not conclusive, is at least an evidentiary admission by the purchaser." (footnote omitted)).

[47] A non-reliance or anti-reliance clause may also be part of an integration clause. *See, e.g.*, POWELL, *supra*, § 81.05[11][a] at 81-245 (quoting a New York form summarizing the general rule regarding integration clauses (". . . neither party relying upon any statement made by anyone else that is not set forth in this contract." (footnote omitted)).

The effectiveness of such clauses varies from jurisdiction to jurisdiction.[48] *Real estate* parties (again, particularly sellers) will often request similar clauses; but the *disclaimers* may be referred to as *as-is* clauses[49] and may run on for several paragraphs,[50] and although a *merger clause* is typically considered the same as an *integration clause*,[51] it may take on a new meaning in a real estate purchase agreement[52] more akin to the doctrine of merger associated with a deed.[53] (To avoid confusion, this variant of a merger clause may be referred to as a *deed merger clause* in this article.) Moreover, real estate sellers will often attack this issue head-on by simply adding a *release* of the seller's extra-contractual liability (stating, for example, that the seller and various related parties have no liability in connection with the purchase agreement other than the seller's liability for a breach of the express obligations in the purchase agreement and the closing documents).

But see West & Lewis, Jr., *supra*, at 1018 ("[I]t is important to distinguish between an explicit disclaimer-of-reliance provision and a standard merger or integration clause."); *id.*, n. 130 at 1019 ("While a merger clause many contain a disclaimer of reliance provision and, in some circumstances, could be read to serve a similar function, it is imprudent to assume that a boilerplate section labeled "merger,' 'entire agreement,' or 'integration' specifically includes, or will function as, a disclaimer-of-reliance clause. Moreover, some courts seem to require a disclaimer of reliance to be separated completely from a standard merger or entire agreement clause in order to be enforceable." (citations omitted)).

[48] *See, e.g.*, West & Lewis, Jr. *supra*., which indicates that an *anti-reliance clause* may be more effective than the other clauses discussed in precluding extra-contractual fraud claims.

[49] The success of as-is clauses varies depending on the jurisdiction. *See, e.g.*, 1 MILTON R. FRIEDMAN & JAMES CHARLES SMITH, FRIEDMAN AND SMITH ON CONTRACTS AND CONVEYANCES OF REAL PROPERTY (8th ed. 2020), § 7:12.1 at 7-65 ("Some courts say the seller's duty to disclose material latent defects is not excused by an 'as is' clause. (footnote omitted). However, inserting an 'as is' clause can never hurt the seller, and often the clause has substantial impact. In most states a buyer can render an 'as-is' clause impotent by framing the claim as fraud, assuming of course the ability to meet the requirements for proof of fraud.").

[50] The excessive length of some as-is clauses may be attributable in part to New York case law. *See, e.g.*, 1 FRIEDMAN AND SMITH, *supra*, § 7:12.2 at 7-69 ("New York, apparently alone, has held that if there is a specific disclaimer of enumerated items, . . ., then the purchaser is estopped as to the matters specified. The case so holding has been criticized . . .); 7 CORBIN ON CONTRACTS, (Rev. ed. . 2002), § 28.21 at 96 ("New York, however, makes a peculiar distinction based on the specificity . . .).

[51] The entry for *merger clause* in BLACK'S simply says "See INTEGRATION CLAUSE," and the definition for *integration clause* is "A contractual provision stating that the contract represents the parties' complete and final agreement and supersedes all informal understandings and oral agreements relating to the subject matter of the contract. – Also termed *merger clause* . . . ." BRYAN A. GARNER, BLACK'S LAW DICTIONARY 1885 (11th ed. 2019) (hereinafter, "**BLACK'S**") 963, 1185; *see also*, 6 CORBIN ON CONTRACTS, *supra*, § 25.7 at 57 (". . . a clause stating that it [i.e., the contract] constitutes the entire understanding and agreement between the parties (a 'merger' or 'integration' clause) . . .").

[52] "A merger clause provides that the parties' promises and representations made prior to closing are merged, or terminated, at closing when the seller delivers the deed." 1 FRIEDMAN AND SMITH, *supra*, § 7:12.2 at 7-68. But even this special variant of a *merger clause* "does not always bar parol evidence that the written agreement is not a complete integration of the agreement of the parties . . ." id at 7-69 (footnote omitted).

[53] The common law doctrine of merger (discussed further in 2.6.3) "is merely an application of the contract doctrine of integration" where the deed (as opposed to the purchase agreement) is viewed as the final contract. 14 POWELL, *supra*, § 81A.07[1][d] at 81A-136. The foregoing statement, however, may be an oversimplification. A *deed merger clause*, as described in the immediately preceding footnote, may contractually expand the merger doctrine significantly. See 2.6.3 below.

2.5.1 Enforceability of Releases. Are such releases (which, to the extent they are intended to relieve a party from a negligent or wrongful act, may be referred to as an "exculpatory clause"[54]) effective to eliminate tort liability? Maybe for ordinary negligence, but in many jurisdictions, it is not clear that they do much more.[55] As explained by CORBIN ON CONTRACTS:

> The general rule of exculpatory agreements is that a party may agree to exempt another party from tort liability if that tort liability results from ordinary negligence. Courts do not enforce agreements to exempt parties from tort liability if the liability results from that party's own gross negligence, recklessness, or intentional conduct.[56]

Some states have codified this rule or some variant of it. For example, in California:

> All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.[57]

But note that, unlike the quoted text from CORBIN ON CONTRACTS, the California statute mentions *fraud*. And *fraud* may include *negligent* misrepresentation.[58] So it is not clear how much good

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[54] *See, e.g.*, BLACK'S, *supra*, at 712 (which defines an "exculpatory clause" as "A contractual provision relieving a party from liability resulting from a negligent or wrongful act.").

[55] A release that is effective when the purchase agreement is signed might establish a clean slate insofar as *past* torts are concerned, as intimated in the immediately following footnote; but fraud in the inducement may not be viewed as a *past* tort (and if the release is not effective until the closing and the closing does not occur, there may be no release at all). See discussion of *Variel*, *supra*.

[56] 15 CORBIN ON CONTRACTS, *supra*, § 85.18 at 409 (footnote omitted which cites numerous federal cases and cases from 7 states, noting that "[s]ome states forbid exculpatory provisions regarding the actor's own negligence."); *see also*, Restatement (Second) of Contracts § 195 (1981); CORBIN appears to view an exculpatory clause differently than a release of an existing or asserted duty, which is discussed in 13 CORBIN ON CONTRACTS, *supra*, § 67.9 at 77. Of course, *past* intentional torts and gross negligence claims are frequently settled in settlement agreements and presumably released on an effective basis. Compare WILLISTON, which, in discussing the limitations on exculpatory agreements, speaks of *future* torts: "An attempted exemption from liability for a *future* intentional tort or crime or for a *future* willful or grossly negligent act is generally held void, although a release exculpating a party from liability for negligence may also cover gross negligence in those jurisdictions that have abolished the distinction between degrees of negligence and that treat all negligence alike." (emphasis added). SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 19:24 at 390-397 (Richard A. Lord ed., 4th ed. 2010, 2020); *see also* 1 SENN, *supra*, § 5.04[B][1] at 5-15 ("As-is and release clauses do not shield the seller from liability for fraudulent misrepresentations, for which a separate claim may lie under tort law." (footnote omitted)), although negligent misrepresentations may not always be treated the same as intentional misrepresentations.

[57] Cal. Civ. Code § 1668. An almost identical statute appears in North Dakota (N.D. Cent. Code § 9-08-02) and (with a limited exception for certain recreational releases) Montana (Mont. Code 28-2-702).

[58] *See, e.g., Blankenheim v. E. F. Hutton & Co.*, 217 Cal. App. 3d 1463, 1472-73 (1990) (California "case law has long held that negligent misrepresentation is included within the definition of fraud."); RESTATEMENT (SECOND) OF TORTS § 526, cmts. e and f (1977) ("e. In order that a misrepresentation may be fraudulent it is not necessary that the maker know the matter is not as represented. . . . f. A misrepresentation [may] be fraudulent even though the maker is honestly convinced of its truth from hearsay or other sources that he believes to be reliable.").

a release does, especially in states such as California.[59] It may be comforting to real estate buyers that the more heavy-handed (and direct) *release* approach in real estate transactions may not be as effective as the more surgical *anti-reliance* approach in corporate transactions in providing a defense to an extra-contractual future fraud claim: if there is no reliance, then an essential element of fraud is missing; and some jurisdictions may accept a disclaimer of reliance as fact (or at least evidence indicating the absence of reliance).[60]

2.5.2 Fraud Carve-Outs. But many buyers do not want to take chances when it comes to fraud. Consequently, buyers often ask for a *fraud* carve-out, which undermines the limiting clauses described above (arguing, for example, that "[n]o sophisticated buyer would agree to be defrauded").[61] Fraud carve-outs are apparently very common in corporate acquisitions,[62] and the author encounters them frequently in real estate purchase agreements. However, as noted above, *fraud* is a broad term that (contrary to the understanding of many real estate professionals) may encompass much more than a lie.[63] Despite the literature on this subject, *fraud* remains undefined in many corporate purchase agreements.[64] The author suspects that this problem is even more pervasive in real estate purchase agreements.

2.5.3 The Form. How does one compromise the seller's desire to limit its liability to the contract, on the one hand, and the buyer's desire not to be defrauded, on the other hand? This task is all the more challenging in light of the varying approaches of different jurisdictions. As discussed in more detail later, the Form includes a *fraud* carve-out within the term *Fraudulent/Bad Faith Seller Breach*, which is defined narrowly in an attempt to avoid

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[59] However, even in California, a seller might be able to shield itself from liability for negligent misrepresentation if it discloses that it has not verified the information it is providing. *See, e.g.*, 1 MILLER & STARR, CALIFORNIA REAL ESTATE (4th ed. 2019) § 1:172 at 1-755—1-756. Query whether negligent misrepresentation can ever arise as a result of a knowledge representation where knowledge is defined to exclude any obligation to investigate (recognizing, of course, that there may be a fraudulent misrepresentation if the seller has actual knowledge to the contrary)? Also, a California appellate court has stated that when all the elements of fraud precede the formation of the contract, a release of such fraud may be effective. *SI 59 LLC v. Variel Warner Ventures, LLC* 29 Cal.App.5th 146, 152 (2018). According to *Variel*, "multiple cases state that [§ 1668] applies only if a future tort is involved," but "whether section 1668 might apply to past torts is a slippery question" (and in the case of fraudulent inducement, "reliance is not a past event; the reliance is the signing of the contract and the changing of the legal positions, which is concurrent with the exemption clause."). *Id*. *See also*, notes 55 and 56, *supra*.

[60] *See, e.g.*, West & Lewis, Jr., *supra*, part IV.

[61] Timothy A. Miller, *Just Say No – Protecting Buyers from Unintended Consequences of Reliance Disclaimers in M&A Transactions,* L.A. DAILY JOURNAL 7 (Mar. 9, 2017).

[62] *See, e.g.*, SRS Acquiom Inc., *2020 M&A Deal Terms Study* (May 2020) ("**2020 SRS Study**"); Glenn D. West, *Your Mother Was Right: Following Your Friends (or Market Studies) Off a Bridge Is a Bad Idea*, GLOBAL PRIVATE EQUITY WATCH (Jan. 28, 2020) ("[T]he 2019 ABA Private Deal Point Study also reveals that a substantial majority of the non-reliance clauses . . . include express fraud carve-outs.").

[63] *See, e.g.*, Glenn D. West, *That Pesky Little Thing Called Fraud: An Examination of Buyers' Insistence Upon (and Sellers' Too Ready Acceptance of) Undefined "Fraud Carve-Outs" in Acquisition Agreements*, 69 BUS. LAW. 1049 (Aug. 2014) ("**West Fraud Article**"); *Blankenheim, supra; and* RESTATEMENT (SECOND) OF TORTS § 526, *supra*.

[64] *See, e.g.*, Winston & Strawn, *supra* ("[T]he nearly ubiquitous 'fraud carve-out' . . . layers additional complexity onto the post-closing landscape, particularly when, *as is common*, the term 'fraud' itself is left undefined." (emphasis added)).

dragging in all but the most serious claims (e.g., it would not cover alleged representations outside of the contract); but not as narrowly as the corporate seller-side literature on the subject may advocate. This issue is sufficiently controversial that there may be revisions to the definition in the current draft of the Form.[65]

2.6 **Contractual Limitations on (and Expansions of) Enforcement**. If a party has a viable claim that is not precluded by the types of clauses mentioned in 2.5 above (e.g., because the claim is for a breach of the purchase agreement as opposed to a tort claim), there may be other remedy limitations in the purchase agreement that, if enforced, would protect the other party from all or a part of the claim. And while the particular clause discussed in 2.2.2 above (limiting the buyer's remedy to cancellation and a deposit refund if the closing fails to occur due to the seller's default) is rare in the commercial context, there are many other remedy limitations requested by the parties (particularly, sellers) that frequently appear in commercial purchase agreements. On the other hand, some purchase agreements may try to expand a party's enforcement rights (by, for example, trying to extend the statute of limitations). The use of such limitations (and expansions) in the Form will be discussed later, but some of these limitations (and expansions) raise legal issues that will be mentioned now.

2.6.1 No Recourse Against Insiders. As noted earlier, each of the parties is typically an SPE. Moreover, the SPE is typically a limited liability company or a limited partnership (with a general partner with no assets beyond its interest in the deal). While the limited liability shield of the relevant entity may generally protect insiders (i.e., the owners, officers, directors and others behind the scenes) from liability for the entity's contract breaches and torts, it is possible to pierce that shield in some circumstances (e.g., using an alter ego theory when the entity is not operated as a separate and distinct entity)[66] and the shield may, of course, not be relevant in the case of a tort claim if the insider has participated in the tort. This liability, in the case of torts, may be limited for a seller's insiders when a seller release is used (that also runs in favor of the seller's insiders) to the extent the release is enforceable. But a purchase agreement release of the seller generally does not apply to breaches by the seller of the purchase agreement. Consequently, some real estate sellers take the additional step of including a *no-recourse* provision in the purchase agreement that benefits only the insiders (and not the seller itself). The enforceability of such limitations (regardless of the party whose insiders are covered) may vary depending on the jurisdiction, and courts may be reluctant to eliminate liability for participation in an intentional tort.[67]

2.6.2 Knowledge Waivers (Anti-Sandbag vs Pro-Sandbag). What if the buyer knows of a breach of a seller representation before closing, and then the buyer proceeds with closing? There are some jurisdictions in which the buyer will be deemed to have waived its claim; but there may be no such waiver under the modern common law rule.[68] In contrast to

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65 See 3.3.7 below.

66 *See, e.g.*, Glenn D. West & Natalie A. Smeltzer, *Protecting the Integrity of the Entity-Specific Contract: The "No Recourse Against Others" Clause – Missing or Ineffective Boilerplate?*, 67 BUS. LAW. 39 (Nov. 2011).

67 *See, e.g., id.* at 69.

68 *See, e.g.*, Allison J. Sherrier, *The Sandbagging Conundrum Explained*, CLA LEXOLOGY (Jan. 19, 2020); Charles K. Whitehead, *Sandbagging: Default Rules and Acquisition Agreements*, 36 DEL. J. CORP. L. 1081 (2011);

the author's experience in real estate transactions, in corporate transactions it appears to be (x) common to include pro-sandbag clauses which expressly preserve the buyer's claim after closing despite its knowledge beforehand, (y) rare to include anti-sandbag clauses that waive the buyer's claim, and (z) common to have neither clause.[69] The Form includes an anti-sandbag clause, which will be discussed later.

2.6.3 Survival Provisions. Purchase agreements often contain survival provisions both as to *termination* and as to *closing* and appear to be intended for at least two different purposes (or both): (1) to change the period of time during which a cause of action may be brought for a breach that occurs prior to or at the time of termination or closing, or (2) to avoid extinguishing future obligations (i.e., ending the relevant obligatory period for) certain obligations, such as confidentiality or indemnification obligations, by terminating or closing.

- *Termination*. In the case of *termination*, the parties may provide that portions of the contract are not being terminated (so that rights and obligations under those portions of the contract continue after termination) or that liability for a breach may survive for a period that varies from the applicable statute of limitation.[70]

- *Closing*. There may be similar provisions regarding the period after *closing* (intended to have certain portions of the contract continue to apply during a period after closing or to modify the applicable statute of limitations for a breach). The concern of the parties (and particularly the buyer) with the closing extinguishing both obligations and liabilities may stem from the *doctrine of merger*:

  > Upon delivery of the deed, the parties' rights under the contract are extinguished. This is known as the 'doctrine of merger' since the parties' rights under the contract are viewed as being merged into the rights represented by the deed.[71]

  Such broad statements of the *merger doctrine* have led some practitioners to conclude that, for example, the representations and warranties of the seller would merge into the deed without a survival clause. But the *merger*

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but as to California law, *see, e.g.*, Stevens A. Carey, *California Purchase and Sale Issues for Buyers – Updated*, PRAC. REAL EST. LAW. § 5.4.4 at 45 (Jan. 2020) [hereinafter, the "**Carey CA PSA Article**"].

69 *See, e.g.*, 2020 SRS Study.

70 S*ee, e.g.*, 13 CORBIN ON CONTRACTS, *supra*, § 67.2 at 12 ("Although termination and cancellation of an agreement extinguish future obligations of both parties to the agreement, . . . the rights of the parties with respect to performances rendered or a breach committed before the [termination] notice became operative depends [sic] upon the provisions of the 'terminated' contract.").

71 14 POWELL, *supra*, § 81.01[2][d] at 81-15; *see also, id* § 81.05[11][d] at 81-247 ("Generally, no contractual promises survive the closing under the common law doctrine of merger." (footnote omitted)).

doctrine may be much more limited than the language quoted above may suggest:

> The doctrine of merger does not apply to collateral issues other than title that may arise as disputes between purchaser and seller.[72]

Ultimately, "the merger doctrine should only be applied as a canon of construction that attempts to arrive at the true intention of the parties to a deed."[73] There is a sufficient amount of confusion about the *merger doctrine* that the outcome may vary depending on the facts, the jurisdiction and the court.[74] To avoid leaving this matter for the courts, it is advisable to make the intent of the parties clear.

- *Statute of Limitations*. However, the parties' ability to effectively shorten or lengthen the applicable statute of limitations may vary from jurisdiction to jurisdiction.[75]

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[72] 14 POWELL, *supra*, § 81.03[6][h] at 81-153 (footnote omitted); *see also, id* § 81A.07[1][d] at 81A-136–81A-137("[I]f a provision in a prior contract involves an issue which is not appropriate to a deed and is not commonly contained in a deed, no merger should occur. Usually, matters relating to title are germane to a deed are thus considered to merge. Other matters . . . are often considered to be collateral to the purpose of the deed and therefore do not merge." (footnotes omitted)).

[73] 14 POWELL, *supra*, § 81A.07[1][d] at 81A-136 (footnote omitted). *See also*, 13 CORBIN ON CONTRACTS, *supra*, § 67.12(2)(d) at 123 ("The acceptance of a deed . . . is occasionally held to operate as a discharge of all the prior contractual obligations of the vendor with respect to title . . . . This is explained by a now-discredited theory of 'merger by deed.' It is best understood under the theory of [discharge by performance]. The purchaser voluntarily assents to the limited deed . . . as a satisfactory performance and a discharge of the vendor's contractual duties. Without evidence of the [seller's] intent to make a gift, the [seller's] obligations are not discharged by . . . partial performance . . . by delivering the deed." (footnotes omitted)); 13 CORBIN ON CONTRACTS, *supra*, § 73.4 at 499 ("[T]his is a discharge by accord and satisfaction or substituted contract and not by 'merger.'"); Restatement (Second) of Contracts § 275, cmt. a ("Under the discredited concept of 'merger by deed' it has sometimes been held that the contract duties of a seller of land are discharged by the buyer's mere acceptance of a non-conforming deed . . . . That concept is rejected in this Restatement, but the seller's duties may be discharged under the rule stated in this Section ["Assent to Discharge Duty of Return Performance"] if the buyer manifests his assent to take the deed as full performance." (footnotes omitted)).

[74] *See, e.g., Beware the Merger Doctrine: Rights in a Real Estate Contract can be Lost under the Doctrine of Merger*, Findlaw (Last Updated 8/31/17).

[75] *See, e.g.*, Carey CA PSA Article, *supra*, § 5.3 at 40-43; FLA. STAT. § 95.03 (2015) (which provides that "[a]ny provision in a contract fixing the period of time within which an action arising out of the contract may be begun at a time less than that provided by the applicable statute of limitations is void."); TEX. CIV. PRAC. & REM. CODE § 16.070(A) (one may not limit a party's right to bring suit on a contract for a period of less than two years); 1 FRIEDMAN AND SMITH, *supra*, § 7:12.2 at 7-68 ("A provision that representations of fact are not to survive the closing does not bar an action for intentional tort." (footnote omitted)). Some commentators have stated that the statute of limitations (and therefore the statutory constraints on shortening the applicable statute of limitations) in Texas is not relevant after the closing for those obligations in the purchase agreement that merge with the deed (based on the clear intent of the parties under a deed merger clause) because such obligations have been satisfied (and replaced by the deed) so there is no longer a basis for a claim. *See, e.g.*, Steven A. Waters, *Representations, Warranties, Covenants and Conditions in Commercial Real Estate Contracts*, State Bar of Texas, Advanced Real Estate Course, v. 2 at DD-11—DD-25 (1986), which raises the question: If the parties can effectively agree to no survival whatsoever and cut

- *Indefinite Periods*. Also, if the purchase agreement appears to obligate a party to comply with an obligation for an indefinite period of time (whether after closing or termination), it may not be enforced as written.[76]

The Form contains reciprocal survival provisions, which will be discussed later.

2.6.4 Voiding the Purchase Agreement. Some purchase agreements state that when a party cancels the purchase agreement because of the other party's breach, the purchase agreement is *void* (e.g., upon the exercise by the seller of a cancellation right triggering liquidated damages). But if the purchase agreement were truly *void*,[77] then what would happen to the rights the parties intend to have after cancellation (e.g., how would a seller have the right to obtain the deposit after exercising a cancellation that purportedly gave rise to liquidated damages)? The author suspects that many if not most voiding provisions in real estate purchase agreements are not intended as written.[78]

2.6.5 Certain Damage Limitations. There are three limitations on damages that sellers often seek to include a real estate purchase agreement:

- if the closing occurs, a cap (i.e., a maximum limit) on the seller's post-closing liability for damages;

- if the closing fails to occur due to the seller's breach, no damages at all or a limited amount of reimbursement of the buyer's out-of-pocket costs; and

- whether or not the closing occurs, an exclusion of certain types of damages (e.g., consequential or punitive damages).

Subject to limited exceptions, "the courts see no harm in express agreements limiting the damages to be recovered for breach of contract."[79] The author is not aware of any challenges

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off any claims at the time of closing, should they also be able to defer the date of the merger or accord and satisfaction (when the obligation is deemed satisfied, thereby cutting off any basis for a claim) to a date after closing but sooner than what is otherwise required by the minimum statute of limitations?

[76] *See, e.g.*, 1 CORBIN ON CONTRACTS, *supra*, § 4.2 at 701 ("The result generally reached is that the time is neither unlimited nor discretionary."); 57 Sylvia Powar, *"Perpetual Contracts" Under California Law*, L.A. Assn of Bus. Trial Lawyers Report (Summer/Fall, 2018) (". . . California courts will attempt to avoid construing the contract as perpetual . . . if neither an express nor an implied term can be found, the term of duration will be construed to be a reasonable time."); Glenn D. West, *Forever is a Long Time or No Time at All: More Idiosyncrasies of the Common Law of Contract You Need to Know*, JD *Supra* (June 24, 2019); 2 FRIEDMAN AND SMITH, *supra*, § 22:2.1 at 22-50 ("If there is no fixed time for the duration of a restriction, the covenant is limited to a reasonable amount of time . . ." (footnote omitted)); SENN, *supra*, § 5.04[B][4] at 5-21 ("If the indemnity clause does not state the period of its duration, it may be terminated at the will of either party." (footnote omitted)).

[77] BLACK'S *supra*, defines *void* to mean "Of no legal effect," stating: "Whenever technical accuracy is required, *void* can be properly applied only to those provisions that are of no effect whatsoever – those that are an absolute nullity."

[78] *See, e.g.*, 2 CORBIN ON CONTRACTS, *supra*, § 6.15 at 319 ("Even when it is said that the contract shall be 'null and void' on B's non-performance, the words seldom mean what they seem to mean.").

[79] 11 CORBIN ON CONTRACTS, *supra*, § 58.16 at 491, which goes on to state at 492: "[The parties] may later regret their assumption of the risks of non-performance in this manner, but the courts generally let them lie on the bed

to such provisions in the context of a real estate purchase agreement (except as discussed in 2.2.2 above). The first two limitations above are relatively straightforward, but there is a surprising amount of confusion associated with the third limitation, and in particular, the meaning of *consequential* damages.[80] Consequential damages may not include certain *lost profits* (including the lost profit component of the typical benefit of the bargain damages that may be awarded when a party wrongfully fails to close), namely, when the lost profits constitute *direct* rather than *indirect* damages (although *all* lost profits may be and sometimes are separately covered by the damage exclusion).[81] The Form contains all three of the limitations described above, and the waiver of *consequential* and *punitive* damages is mutual, but there may be future discussion of eliminating the consequential damage waiver (while retaining the punitive damage waiver) as some commentators have recommended.[82]

3. SELLER BREACH DURING THE CONTRACT PERIOD

This article will now consider some of the alternative drafting approaches taken in real estate purchase agreements, and explain the drafting approach taken by the Form. Our initial focus will be on breaches during the contract period (i.e., before closing or termination).[83] The drafting approach for real estate purchase agreements may be very different from corporate acquisition agreements. In the corporate acquisition context, it has been said that "[i]ndemnification is generally drafted as a post-closing matter, with the parties tacitly agreeing to leave the resolution of pre-closing breach of contract claims in the event the deal does not close, and the appropriate measure of damages, to a court of competent jurisdiction."[84] By contrast, in the real estate context, some relatively customary approaches to contract period breaches have evolved. We will begin with how to address *seller* breaches during the contract period. In the forms and commentary reviewed by the author, the most commonly stated remedy of the buyer when the *seller* breaches the purchase agreement during the contract period (including a breach of the obligation to close) is either to (1) cancel the contract and obtain a refund of the deposit, or (2) seek specific performance.[85] But there are variations to and deviations from this approach.

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they made." Not surprisingly, there may be "an exception for unconscionable contracts and contracts where the parties have unequal bargaining power." *Id.* at 493. There may also be an exception for willful misconduct. *Id.* at 493-494. But an intentional breach may not be enough. *See, e.g.*, *Electron Trading*, *supra* (a non-real estate case in which an *intentional breach* was not sufficient to override a contractual limit on damages). *See also*, 15 CORBIN ON CONTRACTS, *supra*, § 83.7 at 247 ("Parties may, by contract, limit the remedies available to them in the event of breach."), and the discussion that follows.

80 *See, e.g.*, Glenn D. West, *Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic Excluded Losses Provision in Private Company Acquisition Agreements*, 70 BUS. LAW. 971 (Fall 2015) ("**West Consequential Damages Article**"); Glenn D. West & Sara G. Dugan, *Reassessing the Consequences of Consequential Damage Waivers in Acquisition Agreements*, 63 BUS. LAW. 777 (May 2008).

81 *See, e.g., id.*

82 *See, e.g., id.*

83 The *contract period* is sometimes referred to as the *pre-closing period* or the *executory period*, with the understanding that the period ends if the contract is terminated before a closing occurs.

84 2 KLING & NUGENT, *supra*, § 15.01 at 15-5 (footnotes omitted).

85 *See, e.g.*, SENN, *supra*, § 5.05 at 5-25 ("[C]ustom dictates that a buyer is typically afforded two options when the seller has defaulted: (i) terminate and receive a refund of its deposit money; or (ii) seek specific performance.");

3.1 **No Specific Performance**. Although rare in the author's experience, some sellers are unwilling to put their property at risk by allowing the remedy of specific performance.

3.1.1 Damages as an Alternative. Some sellers do not want to give the buyer any right to tie up the property, and to that end may be willing to allow the buyer to pursue an action for damages rather than permit the buyer to seek specific performance.[86] But this position is atypical in the author's experience. Many if not most buyers have come to expect a right of specific performance, often with a short fuse, and many sellers are more concerned about limiting any monetary remedy.

3.1.2 Cancellation/Refund as Sole Remedy. As discussed in 2.2.2, some sellers refuse to allow specific performance *or any other remedy* other than cancellation of the purchase agreement and a refund of the deposit. Although this position is also rare, the author has encountered it from time to time. But given the one-sided nature of this approach (not to mention the enforceability issues in some jurisdictions), it does not seem to belong in a balanced pre-negotiated form.

3.2 **Subject Breach**. Sometimes the purchase agreement appears to allow the buyer to cancel the purchase agreement and obtain a refund of the deposit for *any breach* by the seller, without any limitation as to the materiality, timing and duration, or nature of the breach.[87] But, in the author's experience, that is the exception rather than the rule: some limitations typically appear.

- *Materiality*. Contracts often give the buyer the right to cancel the contract by reason of a breach by the seller only if the breach is "material."[88]

- *Timing and Duration*. In some contracts, cancellation and refund of the deposit are not available unless (x) the breach exists as of the scheduled closing date,[89] (y) the

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STEIN, *supra*, § 2.78 ("Increasingly, purchase agreements provide that the seller is not subject to damages, and that the buyer's exclusive remedies are either to sue for specific performance or to terminate the purchase agreement."); *see also*, n. 95, *infra*.

86 *See, e.g.*, CALIFORNIA CEB SALES BOOK, *supra*, § 4.177 (Form: Remedies for Default), § 9.4 at 4-191–4-192 ("BUYER WILL NOT HAVE THE RIGHT TO RECEIVE ANY EQUITABLE RELIEF, INCLUDING . . . THE RIGHT TO RECORD A LIS PENDENS OR TO PURSUE THE SPECIFIC PERFORMANCE OF THIS AGREEMENT, BUT BUYER WILL HAVE THE RIGHT TO PURSUE AN ACTION FOR DAMAGES . . . .").

87 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:34 [PSA for retail real estate] (updated 2019–20), § 9 at 8-196 ("In the event that: . . . d. Sellers . . . breach . . . this Agreement; then Buyers shall have the right . . . to terminate this Agreement and obtain a complete refund of their deposits . . . .").

88 *See, e.g.*, SAFT, *supra*, § 9:26 [Form PSA], § 11 [Seller Default] at 9-91 (defined as "a *material* breach or default by Seller in any of its representations, warranties, covenants or obligations under this Agreement . . . .") (emphasis added), § 13.2(iv) [Purchaser's Right of Termination] at 9-102.27, and § 13.2(d) [Seller Default] at 9-102.28.

89 *See, e.g.*, STEIN, *supra*, App. B, § 5.1 (Purchaser Conditions, which include material accuracy of representations as of closing in 5.1.1 and material performance of covenants required at or prior to Closing in 5.1.2), §§ 5.2, 8.3 (Purchaser right to terminate and obtain a refund of deposit by reason of failure of Purchaser condition or Seller's wrongful failure to close). (Notes: (x) Although the time when the Purchaser conditions must be satisfied is not expressly stated, a reading of Section 5.1, 5.2 and 8.3 suggests that the conditions may be satisfied at or prior to the scheduled closing date (e.g., the parties presumably intend that title and tenant estoppel conditions may by satisfied

breach remains uncured for a specified cure period after written notice,[90] or (z) both.[91]

- *Nature*. Often, the buyer's right to terminate the contract by reason of the seller's default is limited to defaults of a particular nature, most commonly a breach of the seller's obligation to close the transaction.[92]

Some contracts appear to narrow the scope of the subject breach by referring to *a failure of closing by reason of a seller default*. However, if the purchase agreement conditions the buyer's obligation to close on the absence of *any seller default*, then doesn't cancellation under this condition constitute *a failure to close by reason of a seller default*? In that event, there may be no limitation at all as to the materiality or nature of the breach, but there may be a temporal limitation (if the condition is not tested until the scheduled closing date or requires notice and a cure period or both).[93] If this closing condition is limited to "material" defaults, then such a contract would also impose a materiality limitation. Some contracts take this approach more directly (by referring to the failure of a no-default closing condition in the default cancellation remedy section).[94]

3.3 **Exclusive Remedy?** In many if not most purchase agreements prepared by sellers and reviewed by the author, the alternative buyer's remedies for a seller breach prior to closing described above (i.e., either (x) cancelling the purchase agreement and obtaining a refund of the

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at or prior to the scheduled closing date) so performance may occur any time on or before the scheduled closing date and therefore the default must exist as of the scheduled closing date; (y) Section 8.3 cross-references the wrong section numbers, 6.1.1 and 6.1.2, as the Purchaser closing conditions, but it is clear from the context that 5.1.1 and 5.1.2 were intended because the language refers to "any condition set forth in Section 6.1.1 or 6.1.2" (and the conditions to Purchaser's obligations are in Section 5.1); (z) Section 5.1.1 refers to the "Closing Date," which is defined in Section 1.1 to be "the date on which the Closing occurs," but it is clear from the context that the scheduled closing date was intended in Section 5.1.1.).)

90 *See, e.g.*, SAFT, *supra*, § 9:27 [PSA], § 14 at 9-102.56 ("If Seller is in default hereunder for failure to comply with any one or more of material terms and conditions of this Agreement and such failure continues for more than ten (10) business days after . . . notice . . . , Purchaser as its sole option may (i) terminate this Agreement [and obtain] a full return of the Downpayment . . . .").

91 *See, e.g.*, STEIN, *supra*, App. B, § 8.3 at 393 ("[A]nd if such default is not cured and/or such condition is not satisfied within five (5) days after Purchaser has given Seller written notice of the same . . . ."). However, this cure right does not appear in Section 5.2, which gives Purchaser the right to terminate (and obtain a refund of its deposit) due to a failure of condition (and therefore the cure right could be read only as a requirement for specific performance or reimbursement under Section 8.3 but not for cancellation due to a default without reimbursement under 5.2).

92 *See, e.g.*, SAFT, *supra*, § 9:30 [Multifamily PSA], § 10.2 at 9-212.15 ("If Seller shall refuse or fail to convey the Property . . . ."); *compare* SENN, *supra*, EX. 5-3, § 14.1 at 5-73 (which allows for cancellation by the buyer if "Seller fails or refuses to timely convey the Property" but also contains bracketed provisions allowing for cancellation by the buyer "If [Seller fails to comply with any covenant set forth in Section 8.4] or"; Section 8.4 contains the seller's interim covenants (e.g., to obtain the buyer's consent to certain leasing activity)).

93 *See, e.g.*, SAFT, *supra*, § 9:31 [Mall PSA], § 10.2 at 9-268 (giving the buyer the right to cancel the contract and obtain a refund of the deposit if "the Closing does not occur as a result [of Seller's default]") and § 9.2.1 at 9-262 (conditioning the obligation of the buyer to close on the seller having "delivered to Buyer all of the documents, and [taking] all of the other actions expressly required of Seller in this Agreement").

94 *See, e.g.*, STEIN, *supra*, App. B, § 8.3 (the seller default section of the remedies article) at 393 (a failure of buyer's closing conditions based on the absence of a material seller breach triggers buyer's right to cancellation and a refund of the deposit).

deposit, or (y) specifically enforcing the purchase agreement) are the sole remedies of the buyer.[95] Some of these purchase agreements make clear that the buyer also has the alternative of not exercising either remedy and may set forth other potential actions (e.g., waiving the default and proceeding with the closing or giving the seller additional time to cure), rather than remedies, that the buyer may take.[96]

3.3.1 Unlimited (or Very Broad) Remedies. On the other hand, buyer-oriented purchase agreements may have few, if any, limits on the buyer's remedies for a breach by the seller prior to a closing.[97] But such purchase agreements are rare in the author's experience when dealing with sophisticated parties with roughly equal bargaining power.

3.3.2 Common Compromise Approach. When requested by the buyer, the seller is often willing to provide reimbursement of the buyer's out-of-pocket costs in connection with the termination, but such reimbursement is usually, in the author's experience, subject to a cap.[98]

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[95] *See, e.g.*, SAFT, *supra*, § 9:28 [PSA for office building], § 10.1 at 9-163 ("In the event of any material default by Seller under this Agreement, . . . Purchaser, as its sole and exclusive remedy, may elect either to: (i) terminate this Agreement and receive a refund of the Deposit in full consideration of any Claims Purchaser may have against Seller, or (ii) commence within thirty (30) days after the date on which the Closing was to have occurred and diligently prosecute an action for specific performance."), § 9:31 [PSA for mall], § 10.2 at 9-268 with similar provisions; 6 DUNLAP-HANNA PENNSYLVANIA FORMS, Form 260-59.13-3 [Definitive Purchase and Sale Agreement] § 25.2 (LexisNexis® Forms 2020) ("**PA. PSA FORM**"); *see also*, n. 85, *supra*.

[96] *See, e.g.*, SAFT, *supra*, § 9:13 [Breach of Contract – Sample Provision], § 1.1(a) at 9-49 and 9-50 ("[I]f, as of the Closing Date, . . . Seller shall have failed to perform any of the material covenants or other agreements which are to be performed by Seller on or before the Closing . . . , Purchaser may, as its sole and exclusive remedies, (A) terminate this Agreement . . . and [take] the Deposit and thereupon the parties shall have no further liability to each other hereunder, except in those obligations which expressly survive the termination . . . , (B) close . . . without reduction of the Purchase Price, or (C) seek to enforce the sale . . . ."), § 9:26 [PSA], § 13(3)(d) at 9-102.28 with similar provisions, § 9:27 [PSA], § 14 at 9-102.56 with similar provisions and a fourth alternative giving the seller an additional 30 days to cure its default.

[97] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:34 [PSA for retail real estate], § 9d at 8-196 ("In the event that: . . . d. Sellers . . . breach . . . this Agreement; then Buyers shall have the right . . . to terminate this Agreement and obtain a complete refund of their deposits. . . . however, in the event of Seller's breach, *Buyers may exercise any other rights they may have for said breach*." (emphasis added)).

[98] *See, e.g.*, 3 MARK D. KAUFMAN, WARREN'S FORMS OF AGREEMENTS § 20.2.01 [Raw Land Purchase Agreement Form] (2020), § 17.1.1 at 28 ("Buyer, . . . as its sole and exclusive remedies, may elect to: 17.1.1.2 Terminate this Agreement by written notice to Seller given on or before the Closing Date, in which event Buyer shall be entitled to recover the Deposit plus reimbursement of all third party costs and expenses incurred with respect to the Property in an amount up to $_____, ..."); SAFT, *supra*, § 9:30 [Multifamily PSA], § 10.2 at 9-212.15–9-212.16 ("Purchaser shall elect as its sole and exclusive remedy hereunder either to (i) terminate the Agreement and recover the Deposit and the actual, third-party out-of-pocket fees, costs and expenses incurred by Purchaser in connection with this Agreement . . . not to exceed $75,000, or; [sic] (ii) enforce Seller's obligations . . . ."); SENN, *supra*, EX. 5-3, § 14.1 at 5-73 ("Buyer may elect one of the following as its sole and exclusive remedy . . . : (i) terminate Buyer's obligations under this Agreement . . . and receive a full refund of the Deposit [OPTIONAL: INCLUDE ONLY IF REQUESTED BY BUYER] [and Seller shall reimburse Buyer for Buyer's actual out-of-pocket third party costs . . . [but] in no event shall such reimbursement . . . exceed the Due Diligence Damages Reimbursement Amount] or (ii) bring an action for specific performance . . . .").

3.3.3 Seller's Markets. As discussed in 3.1.2 above, it is rare in the author's experience that a seller attempts to allow no buyer remedy other than cancellation of the purchase agreement and refund of the deposit (so that there is no right to damages or specific performance). Even in a seller's market, the seller might not be so aggressive,[99] but it may require that the seller *willfully* or *intentionally* breach in order for the buyer to have a right to reimbursement[100] or even a right to specific performance.[101]

3.3.4 Meaningful Cancellation Remedy? First-time buyers in a seller's market are often baffled by the logic underlying some of the seller's positions. The seller's rationale may not be based on any equitable argument. Some positions are taken simply because they can be. And sellers may feel they have more to lose if there is a dispute: tying up the property may be far more painful than tying up a deposit, which generally represents only a small fraction of the value of the property. Many parties, especially sellers, simply want to get the deal done quickly and efficiently, and believe they are taking legitimate steps to minimize ongoing liability within what they believe to be market positions. Of course, the parties may not agree on what is *market*. Unfortunately, most lawyers (including the author) and other real estate professionals are statistically ignorant: there is a tendency to believe that one's own experience is a good indicator of the *market* if one does enough deals; but those experiences are anecdotal (a far cry from a scientific sample) and may be more a reflection of facts that are not representative (e.g., transactions involving an attorney's clients who routinely take particular positions). With that caveat, let's consider the buyer's perspective: If the buyer has posted a substantial deposit that it may lose as liquidated damages if the seller cancels the purchase agreement due to the buyer's default, the buyer may feel that the remedies when it cancels the purchase agreement due to the seller's default are inadequate by comparison.

- *Only Willful Defaults?* Why should the seller get a free pass for a *non-willful* default? If the sale doesn't proceed because of the seller's

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99 *See, e.g.*, *Contract of Sale for Office, Commercial and Multi-Family Residential Premises–A Commentary*, NEW YORK CITY BAR COMMITTEE ON REAL PROPERTY LAW (update of Blumberg Form 125) (2007) ("**NYC PSA FORM**"), *available at* https://www.nycbar.org/pdf/report/commentary.pdf and https://www.nycbar.org/pdf/report/contract.pdf ("In a seller's market, the seller is likely to limit the purchaser's remedy on a seller default to recovery of its downpayment. Sellers take this position in order to prevent a defaulting buyer from initiating frivolous litigation to tie up the property by claiming a seller default. Such a position, of course, effectively prevents a legitimate buyer from obtaining a remedy for a seller default. The form attempts to bridge the gap by allowing the purchaser to obtain either specific performance or damages if the seller *willfully* defaults.").

100 *See, e.g.*, STEIN, *supra*, App. B, § 8.3 at 393 ("Purchaser shall be entitled, as its sole remedy, to either (i) specific performance of this Agreement, . . . or (ii) . . . return of the Deposit and, if the default . . . resulted from the *willful and intentional* act of Seller, recover from Seller of Purchaser's actual out-of-pocket costs . . . (. . . not to exceed in the aggregate $_____)." (emphasis added)); STEPHEN M. EDWARDS, DRAFTING AND NEGOTIATING MASSACHUSETTS CONTRACTS (MCLE) [Exhibit 11B–Commercial Purchase and Sale Agreement] § 10.2 (2013) ("**MA. PSA FORM**") ([I]f, but only if, *the closing of the purchase of the Property does not occur as a result of Seller's intentional and willful failure to close*, then the Seller shall pay to Buyer an amount equal to the out-of-pocket expenses (not to exceed $_____ in the aggregate) incurred by Buyer in finalizing this Agreement and in performing Buyer's due diligence with respect to the Property . . . ." (emphasis added)).

101 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:36 [PSA for hotel], § 7.3 at 8-211 ("In the event that the transaction . . . is not consummated . . . due to default on the part of the Seller . . . , then the Purchaser may elect as it sole and exclusive remedies: (a) to terminate . . . ; or (b) in the event Seller *intentionally* defaults in its obligations to perform, . . . enforce specific performance." (emphasis added)); *see also*, NYC PSA Form, *supra*.

default, it may be adding insult to injury to have the buyer forfeit substantial sums incurred putting the deal together and doing due diligence. The seller may retort that the buyer can do the deal: it has a right to specific performance. But this may be little solace if the deal no longer makes economic sense to the buyer because of the seller's default (e.g., a leasing profile misrepresented by the seller or changed by the seller without the buyer's consent).

- *Is Specific Performance a Meaningful Alternative?* As noted above, cancellation of the purchase agreement may be a *Hobson's* choice due to the seller's default. And even if the deal still makes economic sense, what if specific performance is not available (because, for example, the seller has sold the property to a bona fide purchaser for value)? If there is no meaningful right to specifically enforce the purchase agreement, some buyers will argue that there should be no limits on their other remedies.[102]

Buyers are sometimes successful addressing one or both of these concerns. Sellers tend, in the author's experience, to be more sympathetic to the first point but are reluctant to expose themselves to damages for a contract period default beyond capped reimbursement. When they do, they will typically request at least two limitations, namely that (1) the reason specific performance is not available is due to the seller's *willful* default[103] (and sometimes only particular willful defaults are specified for this purpose, such as selling the property to someone else),[104] and (2) (as discussed more generally in 8.5 below) there is no right to consequential or punitive damages.

3.3.5 Importance of Selecting Reliable Counterparties. In any event, the outcome is rarely perfect. Consequently, the choice of counterparties may be crucial. In dealing with a reputable and sophisticated party operating in the real estate business, the reputational risk alone is often sufficient to deter underhanded dealings. Pre-existing or potentially ongoing relationships (that go beyond the current sale) can also play a significant role: if the parties have successfully concluded real estate sales in the past or are likely to do so in the future, there

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[102] *See, e.g.*, SAFT, *supra*, § 9:30 [Multifamily PSA], § 10.2 at 9-212.16 ("[H]owever, . . . if the equitable remedy of specific performance is not available or does not provide an effective remedy for Purchaser, Purchaser may seek any other right or remedy available at law or in equity.").

[103] *See, e.g.*, NYC PSA FORM, *supra*, § 13.05 ("If Seller shall *willfully* default in the performance of its obligations under this contract, Purchaser shall have the right to seek specific performance of such obligations or damages for all loss, damage and expense suffered by Purchaser, including, without limitation, the loss of its bargain, excluding consequential or punitive damages." (emphasis added)).

[104] *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.08 [Shopping Center Purchase Agreement Form], § 7.1 at 142 ("(d) if and only if Seller shall have defaulted on this Agreement by voluntarily conveying an interest in the Property to a third party such that specific performance shall not be available to Purchaser, then Purchaser may institute an action for actual (but not consequential or punitive) damages."); MA. PSA FORM, *supra*, § 10.2 ("[I]f Seller willfully and intentionally conveys the Property to a bona fide third-party buyer or encumbers the Property in favor of a bona fide third party in a manner the result of which is that specific performance is not an available remedy, then Buyer may seek to recover Buyer's actual damages arising therefrom.").

is often greater assurance that the current sale will proceed without incident (because it may be in the economic interest of the parties to preserve and protect these relationships).

3.3.6 Recalcitrant Seller. But what about a recalcitrant seller (who no longer wants to sell on the stated terms)? The seller has many more obligations than the buyer. Some of those obligations may materially affect the value of the property (e.g., not to enter into or amend leases without the buyer's consent). Sometimes there are material obligations that are unique to the transaction. For example, if the seller owns adjacent property, it might agree that at closing it will sign a non-compete agreement or record restrictive covenants limiting the adjacent property's development or operations, to protect the value of the property being sold. Even if the seller were willing to transfer the property, failure to honor any of these other material obligations could make the deal unpalatable. One may wonder why a seller would not comply with its obligations. But what if the seller finds another buyer who will pay so much more for the property that the seller would come out substantially ahead after reimbursing the buyer for its costs (and what if the seller is facing a potential lawsuit from its investors for signing the current deal without undertaking a full marketing process)? What if specific performance is not available or (if specific performance is available only for the acquisition of the property) no longer desirable (e.g., because a bad lease was executed or the adjacent property was sold to a problematic buyer, such as a buyer with plans to construct a building that would destroy the property's view in contravention of the restrictive covenants the seller had agreed to record at closing)? What if the seller starts behaving in a way designed to discourage the deal (e.g., by not providing access to the property, not seeking tenant estoppels or not sharing those received)? What is the buyer's remedy? It is relatively common to allow the buyer to cancel the purchase agreement, get a refund of its deposit, and recoup its costs up to a cap. But is that enough? Generally, the Form is based on the assumption that the buyer and seller are reputable parties who will act in a reasonable manner. But might a reputable seller, who has duties to its investors, have a conflict if a purchase agreement effectively gives it the option to queer the deal and proceed with a much better deal with someone else? Or is that a mischaracterization of the spirit of the remedy provisions? As noted in 2.3 above, a buyer would argue that the right to elect specific performance is an option of *the buyer* (rather than *the seller*). The seller, on the hand, may argue that if the parties intended an exception to the damage limitation, they would have provided for one. The question is how a court would treat a seller whose breach eliminated the availability of specific performance when there remains a termination remedy that allows cancellation and certain limited damages (i.e., capped reimbursement of out-of-pocket costs). Would the limitation on damages be respected? As discussed in 2.3 above, the answer may not always be clear.

3.3.7 Buyer Protections. If the seller is in material breach of the purchase agreement on the scheduled closing date, the Form allows the buyer to elect one of the following remedies: (1) cancellation of the contract, refund of the deposit, and reimbursement of the buyer's out-of-pocket costs up to a cap, or (2) specific performance. Generally, cancellation of the purchase agreement, refund of the deposit, and reimbursement (up to a cap) are the buyer's sole remedies if it wants to kill the deal.[105] However, the Form provides the following additional protections:

[105] Of course, the buyer may also be entitled to reimbursement of its attorneys' fees in enforcing these remedies.

- *Buyer's Damages Upon Cancellation of the Contract*. If the buyer is not in material breach of its obligation to close, and specific performance is not available, then it may seek other direct damages (beyond the reimbursement cap), but only if the seller's breach constitutes a "Fraudulent/Bad Faith Seller Breach." "**Fraudulent/Bad Faith Seller Breach**" is defined narrowly as follows in an attempt to avoid dragging all but the most serious claims (e.g., it would not cover alleged representations outside of the contract):[106]

  (1) a fraudulent breach by the seller of its representations and warranties in the purchase agreement or the Seller Closing Certificate not disclosed in the Due Diligence Materials (and not known or reasonably accessible to the buyer prior to the DD Disclosure Deadline[107]) made with the intent to deceive the buyer;

  (2) fraudulent withholding by the seller of material information from the Due Diligence Materials (not known or reasonably accessible to the buyer prior to the DD Disclosure Deadline), with the intent to deceive the buyer; or

  (3) a voluntary sale or mortgage of the property by the seller to a third party in breach of the purchase agreement prior to the termination of the purchase agreement when the buyer is not in material breach of its obligation to close.

Fraudulent/Bad Faith Seller Breaches are currently an exception not only from the reimbursement cap (if specific performance is not available and the buyer is not in material breach of its obligation to close), but also from the survival limits discussed in 6 below, the release discussed in 8.1.5 below, the (closing) anti-sandbag provision discussed in 8.3 below, and the post-closing materiality threshold and cap discussed in 8.4 below. However, consensus has not yet been reached on the definition of a Fraudulent/Bad Faith Seller Breach, particularly the third clause,[108] or the relevant consequences. It has been difficult to strike a balance between the desire to protect the buyer from a seller who takes action designed to deprive the buyer of the principal benefits of the purchase agreement, on the one hand, and the desire to

106 *See, e.g.*, West Fraud Article, *supra*.

107 The DD Disclosure Deadline is a date a certain number of days (to be specified in the purchase agreement) prior to the expiration of the due diligence period. It is designed to give the buyer some period of time to react to and take into account due diligence information prior to making its decision as to whether or not to proceed with the sale.

108 Some seller advocates would prefer to eliminate the third clause; and some buyer advocates would prefer to expand it to cover any material and willful breach by the seller under the purchase agreement with bad faith intent to deprive the buyer of the principal benefits contemplated by the purchase agreement when the buyer is not in material breach of its obligation to close. In order to avoid giving the buyer's litigation counsel the argument that any seller breach falls within such a general definition, it is recommended that those who want to expand the definition do so only with reference to specific covenants (which are not likely to be present under the assumed facts for the Form).

avoid hooks that make it too easy for the buyer's litigation counsel to circumvent the negotiated limits on the seller's liability, on the other hand.[109]

- *Consummating the Sale*. Another exception to the exclusivity of the buyer's remedies (for a contract period breach by the seller) is that the seller's liability for damages for contract period breaches survives if the sale is consummated (including consummation because the buyer exercises its right of specific performance), subject to the other limitations in the purchase agreement. This result may not be surprising, may be expected by many parties, and may be apparent in those agreements that include post-closing indemnities for breaches. However, in some purchase agreements, one might conclude that a buyer who specifically enforces the purchase agreement forfeits its right to sue for damages for contract period breaches (because buyer-remedy exclusivity provisions for seller contract period breaches are often written so broadly).[110] But why should the buyer forfeit rights it would have had if the closing had occurred in accordance with the purchase agreement (recognizing that the seller is protected with an anti-sandbag defense for known breaches of representations and warranties,

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[109] Some believe that the scales are already tipped in favor of the buyer because the seller's property is so much greater in value than the buyer's deposit. It may not always be clear who is at fault and sellers may fear that they are unable to sell for an indefinite period of time if there is a dispute. See, e.g., Gerald F. Richman and Mark A. Romance, *Specific Performance of Real Estate Contracts: Legal Blackmail*, The Florida Bar Journal (Nov. 1998, Vol. LXXII, No. 10) ("The mere filing of a suit for specific performance (regardless of … the merits) can potentially tie up your property for several years, with or without … a lis pendens. The reason is simple. It is virtually impossible to obtain title insurance necessary to convey title while an action for specific performance is pending…"). Consequently, some seller advocates argue that if the buyer is entitled to unlimited direct damages when the seller willfully breaches the purchase agreement by transferring or mortgaging the property to a third party, then the seller should be protected from the buyer's wrongfully tying up its property by requiring, as a condition to specifically enforcing the purchase agreement, that the buyer post a substantial bond (e.g., 30% of the purchase price), which is still much less than the value of the property.

[110] Sometimes such exclusivity appears (literally and at first blush) to be the clear intent of the parties, but is inconsistent with the existence of seller obligations that arise (or for which the seller is responsible) after the closing. Although it may not be stated, such broad exclusivity statements appear to be intended to be limited to contract period remedies in light of the post-closing obligations and liabilities of the seller. *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.03 [Comprehensive Land Purchase Agreement Form], § 5.3 at 53 ("Except for the alternative remedies set forth in this Section 5.3 [cancellation/deposit refund or specific performance], Buyer shall have no further recourse or remedy of any kind against Seller whether in law, equity or arising from any other legal theory . . . ."), and also at 53 ("Except as specifically permitted by the provisions of Section 5.3, Buyer agrees and covenants not to sue Seller or commence any litigation against Seller for any cause."). But there are potential post-closing adjustment obligations regarding prorations in § 6.5(b) at 55. Many agreements literally preclude any action for damages (except possibly for capped reimbursement in the event of cancellation) even though they have a post-closing materiality threshold and cap or other evidence of post-closing liability of the seller. *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.07 [Office Building Purchase Agreement Form], § 6.2 at 117 ("Purchaser expressly waives its rights to seek damages in the event of Seller's default hereunder."), but there is also a post-closing materiality threshold and liability cap in § 5.4 at 115; § 20.2.08 [Shopping Center Purchase Agreement Form], § 7.1 at 142 (stating exclusive remedies for seller breach not including damages), but there is also a materiality threshold and cap in § 6.14 at 141; SAFT, *supra*, § 9:26 [Form PSA], § 13.3(d) at 9-102.28 (stating exclusive remedies for seller breach not including damages), but there is also a materiality threshold and cap in § 15.4(b); SENN, *supra*, EX. 5-3, § 14.1 at 5-73–5-74 (stating exclusive remedies for seller breach with no damages other than capped reimbursement in connection with cancellation), but there is also a post-closing threshold and cap in § 8.2.

survival limits, materiality thresholds, caps and other limitations)? And what happens if, for example, there is a six-month survival limit, but it takes seven months to specifically enforce the seller's obligation to convey the property? In the case of specific performance, the Form provides that the date record title transfers to the buyer will be treated as the date of the closing for purpose of determining survival limits.

4. BUYER BREACH DURING THE CONTRACT PERIOD

In the author's experience, the most commonly stated remedy of the seller when the buyer breaches the purchase agreement during the contract period (including a breach of its obligation to close) is the right to cancel the contract and take the entire deposit, usually as liquidated damages.[111] But there are many variations:

4.1 **Subject Breach**. Sometimes the contract may be cancelled and the deposit forfeited for *any breach* by buyer, without any limitation regarding the materiality, timing and duration, or nature of the breach.[112] As discussed in 2.1.1, such a *shotgun clause* may be challenged because it arguably reflects an unreasonable estimate of damages. Moreover, such a broad-brush approach is not acceptable to many buyers. For one or possibly both of these reasons, many contracts include limitations as to materiality, timing and duration, or the nature of the breach:

- *Materiality*. Some contracts provide for liquidated damages only for any *material* breach by the buyer.[113] Query whether this generic limitation results in an enforceable liquidated damages clause? Is it possible for the buyer to materially breach the agreement in two different ways that have significantly different impacts (e.g., if the buyer causes $500,000 of uninsured damage during its due diligence or causes $5 million of damage by wrongfully failing to close)? If so, is a single amount of liquidated damages a reasonable estimate if reasonableness is tested at the time the contract is made? One can argue that the damages to the seller are, in either case, based on the loss of the benefits of the transaction; but in one case, the seller may have cancelled the transaction even though the buyer was willing to proceed. On the other hand, some courts test *shotgun clauses* (at least outside the real estate sale context) based on materiality or as to the particular breach as to

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111 *See, e.g.*, SENN, *supra*, § 5.05 at 5-25 ("A seller is typically afforded a single remedy—termination and forfeiture of the deposit as liquidated damages").

112 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:33 [form PSA for shopping center], § 20 at 8-185 ("[I]f buyer fails or refuses to perform any of buyer's covenants herein, Seller may terminate this Contract and receive the Earnest Money as liquidated damages . . . ."), § 27 at 8-188 ("[A] default on the part of Buyer will allow Seller to retain Earnest Money [sic] as liquidated damages and void this Contract . . . ."), § 8:23 [PSA for apartment building], and § (11) at 8-134 ("If Purchaser defaults under this Agreement, the deposits . . . shall be forfeited as liquidated damages and this Contract shall thereupon become null and void.").

113 *See, e.g.*, SAFT, *supra*, § 9:26 [Form PSA], § 11 [Purchaser Default] at 9-90 (defined as "a *material* breach or default by Purchaser in any of its representations, warranties, covenants or obligations under this Agreement . . . ." (emphasis added)), § 13.1(iii) [Seller's Right of Termination] at 9-102.26, and § 13.3(b) [Liquidated Damages] at 9-102.27. A materiality limitation may also be effected indirectly, as discussed at the end of this 4.1.

which the clause is being applied.[114] Moreover, the author is not aware of any cases in which a liquidated damages clause was not enforced for a buyer's wrongful failure to close because it also would have applied to another material breach. Finally, the risk is that the seller must seek actual damages[115] (which might be an acceptable risk as long as it is not the result when the clause is applied to a wrongful failure to close).

- *Timing and Duration*. In some contracts, cancellation and forfeiture of the deposit are not available unless (x) the breach exists as of the scheduled closing date,[116] (y) the breach *remains uncured for a specified cure period* after written notice,[117] or (z) both.[118] Whether or not timing limitations and cure periods alone would solve the (*shotgun*) enforceability problem is debatable. The buyer would have an opportunity to avoid the forfeiture by curing the breach (prior to the relevant time and expiration of any applicable cure period), but that opportunity may not make the estimate of damages reasonable (and not all breaches are curable).

- *Nature*. Many contracts apply the cancellation/forfeiture clause only to defaults of a particular nature, most commonly a breach of the buyer's obligation to close the transaction.[119]

Similar to the treatment of seller defaults discussed in 3.2 above, some purchase agreements appear to narrow the scope of the subject breach by referring to *a failure of closing by reason of a buyer default*. However, if the purchase agreement also conditions the seller's obligation to close on the absence of *any buyer default*, then doesn't cancellation under this condition constitute *a failure to close by reason of a buyer default*? In that event, there may be no limitation at all as to the materiality or nature of the breach (although there may be one or more temporal limitations if the

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114 *See, e.g.*, Carey Liquidated Damages Article, *supra*, § 12 at 44-45. More generally, in some jurisdictions, the *reasonableness* requirement may be satisfied on a retrospective basis at the time of the breach. *See, e.g.*, *id*, § 8 at 40.

115 *See, e.g.*, 2 FRIEDMAN AND SMITH, § 23:5.9 at 23-40 ("Where the liquidated sum is unenforceable seller may collect the actual damages.").

116 *See, e.g.*, STEIN, *supra*, App. B, § 5.3 (Seller Conditions, which include material accuracy of representations as of closing in 5.3.1 and material performance of covenants required at or prior to Closing in 5.3.2), § 8.2 (Seller right to terminate and obtain deposit by reason of failure of Seller condition or Purchaser's wrongful failure to close). Also, see prior discussion of the typographical errors in § 8.3 (which, like Section 8.2, inadvertently cross references the wrong sections for the closing conditions).

117 *See, e.g.*, SAFT, *supra*, § 9:30 [Multifamily PSA], § 10.1 at 9-212.15 (with cure periods but no stated *materiality* qualifiers).

118 *See, e.g.*, STEIN, *supra*, App. B, § 8.2 at 393 ("[A]nd if such default is not cured and/or such condition is not satisfied within five (5) days after Seller has given Purchaser written notice of the same . . . .").

119 *See, e.g.*, SENN, *supra*, EX. 5-3, § 14.2 at 5-74 ("If . . . Buyer fails or refuses to timely consummate the Closing in accordance with the terms and conditions of this Agreement, ..."); SAFT, *supra*, § 9:28 [Office Building PSA], § 10.2 at 9-164 ("If Purchaser fails to consummate this Agreement, ..."), § 9:29 [Deposit Receipt and Real Estate PSA], § 9.2 at 9-197 ("In the event that Purchaser defaults in the purchase of the Property . . . .").

condition is not tested until the scheduled closing date, or there are cure periods, or both).[120] If this closing condition is limited to *material* defaults, then such a contract would also impose a materiality limitation. Some contracts take this approach more directly (by referring to the failure of a no-default closing condition in the default cancellation remedy section).[121]

4.2 **Exclusive Remedy?** "A buyer generally wants the seller's remedy limited to the forfeiture of the earnest money . . . ."[122] Not all purchase agreements take this approach: some are silent as to exclusivity[123] (which, as discussed in 2.1.3, may mean that other remedies are available, especially specific performance); and some provide for alternative remedies[124] or even what may appear to be additional remedies.[125] The manner in which such contracts will be enforced depends on the facts and the jurisdiction (although additional remedies may be unusual outside the context of an installment land contract or a seller-financed sale).[126] But in the author's experience, such contracts are the exception rather than the rule in a commercial real estate sale between sophisticated parties. Exclusivity of the contract cancellation/deposit forfeiture remedy appears to be very common, although the manner in which it is accomplished and the scope of the exclusivity may vary.

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120 *See, e.g.*, SAFT, *supra*, § 9:31 [Mall PSA], § 10.1 at 9-268 (giving Seller the right to cancel the contract and take the deposit if "the Closing does not occur as a result [of Buyer's default]") and § 9.1.1 at 9-262 (conditioning the obligation of the seller to close on the buyer having "paid all sums of money and [taking] all of the other actions expressly required of Buyer in this Agreement"); ARNOLD & KOVE, *supra*, § 8:38 [PSA for hotel], § 11 at 8-262 (giving the seller the right to the deposit "[i]n the event Buyer shall default . . . in the manner described in Section 4.3," which, in turn, states (at 8-242) that buyer is entitled to the deposit "in the event of a default by Buyer . . . , which default is of such a nature as to discharge Seller from its obligation to perform," and Section 10.1 (at 8-260) conditions the "obligation of Seller to close" on Buyer having "made all of the payments . . . and . . . taken all of the other action required of it in this contract . . . ."). (Note that these two contracts do not actually refer to *any* default. They don't mention a breach of the buyer's representations and warranties, but they do effectively refer to any covenant.) *See also*, CALIFORNIA CEB SALES BOOK, *supra*, containing form default remedy provisions, including liquidated damages at Section 9.2 at 4-190 (which provide for liquidated damages if the closing fails to occur due to the buyer's default) but Section 6.2 at 4-179 conditions the seller's obligation to close on buyer's performance of all covenants (and the absence of a material breach of the buyer's representations).

121 *See, e.g.*, STEIN, *supra*, App. B, § 8.2 at 393.

122 2 FRIEDMAN AND SMITH, *supra*, § 23:1, at 23-3; *see also, e.g.*, STEIN, *supra*, § 2.77 ("The parties often agree that the seller's sole remedy for breach by the buyer will be retention of the earnest money as liquidated damages."). These quotes appear to assume the "breach" is a wrongful failure to close. There may of course be other remedies for other breaches. See 4.2.1 below.

123 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:33 [PSA for shopping center], § 20 at 8-185.

124 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:42 [PSA for land], § 11 at 8-311 ("[H]owever, Seller shall have the right to demand specific performance in lieu of accepting the liquidated damages.").

125 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:37 [PSA for hotel], § (17) at 8-237 ("In the event of a breach of the obligations to be performed by Buyer hereunder, then Seller shall have the right to retain the deposit paid by Buyer hereunder as liquidated damages *in addition to such other rights as Seller may have by reason of Buyer's breach*." (emphasis added)), § 8:49 [PSA for subdivision development with seller financing], § THREE at 8-372 ("In the event . . . Buyer breaches this contract, then the earnest money shall be forfeited, but *such forfeiture shall not affect any other remedies available for such breach*." (emphasis added)).

126 *See, e.g.*, 2.1 above and more generally, Carey Liquidated Damages Article, *supra*.

- *Express Limitation*. Often, if not usually, there is an express limitation that makes the remedy exclusive.[127]

- *Mandatory Remedy*. Sometimes contract cancellation and deposit forfeiture are stated as a *mandatory* remedy.[128]

- *Waiver of Other Remedies*. Exclusivity may also be accomplished, in effect, by waiving other remedies.[129] But in the author's experience, waivers of the seller's other remedies are typically contingent upon exercising the contract cancellation/deposit forfeiture remedy. If merely contingent, then such waivers may, of course, not establish an exclusive remedy. For example, as observed in 2.1.3 above, without an express prohibition of specific performance, a liquidated damages clause in and of itself may not preclude specific performance by the seller of the buyer's obligation to purchase. Often, if not usually, the waiver is expressed in the purchase agreement's stated consequences of cancellation.[130] Sometimes the contingent waiver might appear to be accomplished by stating that the contract is *void* when the deposit is forfeited.[131] As explained in 2.6.4 above, such language may not reflect the intent of the parties. As discussed in 7 below, purchase agreements commonly provide that any further obligation or liability is waived except to the extent it expressly survives.[132] And, as noted in 2.6.3 above, such survival language may be another source of confusion.

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127 *See, e.g.*, SAFT, *supra*, § 9:29 [Deposit Receipt and PSA], § 9.2 at 9-197 ("Such liquidated damages shall be *Seller's sole and exclusive remedy* for any default by Purchaser . . . ." (emphasis added)).

128 *See, e.g.*, SAFT, *supra*, § 9:30 [Multifamily PSA], § 10.1 at 9-212.15 ("If Purchaser shall . . . breach . . . and the breach . . . continues beyond the expiration of the notice and cure period, . . . *the Deposit shall be retained* by Seller as liquidated damages . . . ." (emphasis added)). *But see* 2.1.3 above regarding the possibility that mandatory language alone may not be sufficient to establish exclusivity.

129 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:33 [PSA for shopping center], § (27) at 8-188 ("[A] default on the part of Buyer will allow Seller to retain Earnest Money [sic] as liquidated damages and void this Contract *but Seller hereby covenants and agrees not to invoke specific performance for said breach*." (emphasis added)).

130 The terms "cancellation" and "termination" may have different meanings (e.g., in the context of the Uniform Commercial Code), but the references in this article to cancellation or termination are generally intended to refer to a party's cancellation of, and in accordance with, the purchase agreement, whether by reason of the other party's default or otherwise; and while cancellation generally terminates future obligations, the impact on prior obligations may vary depending on the intent of the parties. *See, e.g.*, 13 CORBIN ON CONTRACTS, *supra*, § 67.2.

131 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:23 [PSA for apartment building], § (11) at 8-134 ("[T]he deposits . . . shall be forfeited as liquidated damages and this Contract shall thereupon become null and void.").

132 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.01 [Raw Land Purchase Agreement Form], § 5.6 at 18 ("[A]nd the parties shall have no further rights, obligations or liabilities with respect to each other under this Agreement, except for those which by their express terms are deemed to survive termination of this Agreement."); SENN, *supra*, App. 5A-A, § 14.1(b) at 5A-53 ("[A]nd Seller and Purchaser shall be relieved from all further liability or obligation hereunder except for the Surviving Obligations.").

- *Combination of Approaches*. Some agreements take more than one of the approaches mentioned above.[133]

Some agreements appear to establish the exclusive remedy limitation very broadly as to *any buyer breach.*[134] Taken to this extreme, such exclusivity seems dangerous: as discussed earlier, if the seller does not limit the liquidated damages remedy to a narrower class of breaches, then it may have a so-called *shotgun* clause, which may not be enforceable; and if it does narrow the class of breaches to which liquidated damages apply,[135] then without some reservation of rights, such a broad "exclusivity" limitation, if read literally, could leave the seller without any remedy for other breaches. Consequently, it is common in the author's experience, not only to limit the breaches that may trigger the seller's right to cancel the contract and obtain the deposit, but also (as discussed below) to (x) reserve the seller's right to pursue other remedies for some or all of the other breaches or (y) limit the exclusivity of this remedy to only certain breaches (e.g., only the subject breach), or (z) both.

4.2.1 Reserving Rights. The purchase agreement may reserve, for example:

- *Indemnification*: indemnification rights (especially those relating to due diligence activities or broker claims).[136]

- Confidentiality: the seller's rights regarding Purchaser's confidentiality obligations.[137]

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133 *See, e.g., id.*; STEIN, *supra*, App. B, § 8.2 at 393 ("If Purchaser defaults in its obligation to proceed to Closing, . . . then the Escrow Agent shall . . . pay the Deposit to Seller as full and complete liquidated damages and as the exclusive . . . remedy of Seller. Upon payment of the Deposit to Seller . . . , this Agreement shall terminate and neither party shall have any further obligations or liabilities to the other party . . . .").

134 *See, e.g.*, SAFT, *supra*, § 9:29 [Deposit Receipt and PSA], § 9.2 at 9-197 ("Such liquidated damages shall be Seller's sole and exclusive remedy for any default by Purchaser, and Seller shall have no other rights against Purchaser under the Purchase Agreement or otherwise."); WARREN'S FORMS, *supra*, § 20.2.07 [Office Building Purchase Agreement Form], § 15 at 39 ("The right to retain the Deposit as full liquidated damages is Seller's sole and exclusive remedy in the event of default hereunder by Buyer . . . .").

135 *See, e.g., id.*, where liquidated damages are available only when "Purchaser defaults in the purchase of the Property."

136 *See, e.g.*, SAFT, *supra*, § 9:27 [PSA], § 14 at 9-102.56–9-102.57 ("Seller, as its sole and exclusive remedy, may terminate this Agreement and receive the . . . Downpayment . . . . Nothing contained in this Section 14 shall in any way limit any indemnification (and any related hold harmless and defense) obligation . . . ."); CALIFORNIA CEB SALES BOOK, *supra*, § 4.142 at 4-132 ("Sellers often exclude from the protection of the liquidated damages provision the buyer's obligations under . . . any indemnification . . . , such as indemnities [relating to] the buyer's inspection . . . [or] Broker's commissions . . . .").

137 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:36 [PSA for hotel], § 7.1 at 8-210 ("The foregoing provisions . . . shall not affect the indemnity and confidentiality obligations of Purchaser . . . ."). See 2.6.3 above and 6 below for discussion of the meaning of *survive*.

- Attorneys' Fees: the seller's right to attorneys' fees.[138]
- Post-Termination Acts: Purchaser's acts after termination.[139]
- So-called "Surviving" Obligations: obligations that *expressly survive termination*.[140]

As further discussed in 7 below, the reservation of *surviving obligations* is the most common approach encountered by the author, where some of the specific obligations identified above are stated to *survive* termination. Post-termination acts are typically not reserved in the author's experience, but may not need to be addressed if the exclusivity provision does not apply to them, as discussed in 4.2.2 below.

4.2.2 Limiting Exclusivity to Relevant Breaches. Sometimes the purchase agreement provides that if a certain breach occurs, then contract cancellation/deposit forfeiture provision is the exclusive remedy.[141] One may not expect the exclusivity of the contract cancellation/deposit forfeiture remedy to extend beyond the breaches as to which the remedy is available. But, to avoid any doubt, the exclusivity is sometimes expressly limited to the types of breaches that may trigger the contract cancellation/liquidated damages remedy.[142]

4.2.3 Both. Some contracts take both steps.[143]

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138 *See, e.g.*, CALIFORNIA CEB SALES BOOK, *supra*, at 4-190 ("NOTHING IN THIS AGREEMENT WILL, HOWEVER, . . . LIMIT BUYER'S LIABILITY FOR . . . BREACH OF BUYER'S INDEMNITY OBLIGATIONS . . . OR FOR ATTORNEY FEES AND COSTS . . . .").

139 *See, e.g.*, SAFT, *supra*, § 9:13 [Breach of Contract – Sample Provision], § 1.2 at 9-51 ("Seller's receipt of the amount stated above as liquidated damages shall be the sole and exclusive relief to which Seller might otherwise be entitled as a result of Purchaser default . . . [But] nothing herein contained shall limit Seller's right to seek damages from Purchaser (i) arising from any indemnity . . . , (ii) due to any slander of title first made by Purchaser after the termination . . . , or (iii) due to any other action with respect to the Property first taken by Purchaser after the termination . . . .").

140 *See, e.g.*, STEIN, *supra*, App. B, § 8.2 at 393 ("Upon payment of the Deposit to Seller . . . , this Agreement shall terminate and neither party shall have any further obligations or liabilities to the other party, except for obligations that expressly survive termination of this Agreement.").

141 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:24 [PSA for multiple apartment buildings (complex commercial transactions)], § (15) at 8-46 ("[I]n the event of default by Purchaser in the consummation of the purchase, . . . Seller's retention of the deposit shall be Seller's sole and exclusive remedy.").

142 *See, e.g.*, CALIFORNIA CEB SALES BOOK, *supra*, at 4-190 ("THE DEPOSITS WILL BE DEEMED LIQUIDATED DAMAGES . . . AS SELLER'S SOLE AND EXCLUSIVE REMEDY . . . FOR BUYER'S FAILURE TO PURCHASE THE PROPERTY.").

143 *See, e.g.*, SENN, *supra*, EX. 5-3, § 14.2 at 5-74 ("If . . . Buyer fails or refuses to timely consummate the Closing in accordance with the terms and conditions of this Agreement, . . . Seller may elect, as Seller's sole remedy, to terminate Seller's obligations under this Agreement . . . and keep the Deposit as liquidated damages. The foregoing provision shall not limit Seller's remedies with respect to certain obligations of buyer which are stated to survive the termination of this Agreement . . . .").

4.3 **Potential Issues**. The risk of a *shotgun clause* (which allows the seller to take the deposit for *any* breach) has been discussed. There may be other issues.

4.3.1 Overlapping Remedies. In some purchase agreements, there may be overlapping remedies because some obligations are covered by both the liquidated damages clause and the seller's reservation of rights.[144] For example, what if (x) the liquidated damages clause applies to any material buyer breach, (y) there is a material breach by buyer of its due diligence obligations (liability for which survives any termination), and (z) the seller reserves all its rights and remedies with respect to *obligations that expressly survive a termination*?

- *Seller Risk.* In light of the issues with *optional* liquidated damages clauses in some jurisdictions,[145] this overlap may raise an enforceability issue (especially if the seller tries to apply the liquidated damages clause to an obligation for which the seller would have remained liable after cancellation).

- *Buyer Risk.* A buyer may not be willing to risk exposure to multiple, even if alternative, seller remedies for the same breach.

4.3.2 Remedies for Breaches Other Than Non-Closing. The parties may have different views as to the appropriate consequences of a buyer breach before the closing other than the buyer's wrongful failure to close.

- *Seller Concern.* Some sellers may be concerned that the deposit is their only meaningful recourse against the buyer if the buyer is (as is often, if not usually, the case) a special purpose entity (SPE) with no other assets.[146]

- *Buyer Concern.* Buyers may argue that they should not lose their deposit for any breach other than a wrongful failure to close. Unlike an SPE seller who may have no assets shortly after closing, the buyer will own the property after closing. Thus, the buyer may argue, the seller should be

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144 Some purchase agreements appear to address this issue inconsistently. *See, e.g.*, STEIN, *supra*, App. B (which provides (1) in § 8.2 at 393, for liquidated damages if seller elects not to proceed with closing due to the failure of the seller's closing condition under § [5.3.2] at 386 that seller has performed in all material respects, (2) in § 8.2 at 393, that further obligations or liabilities are terminated "except for obligations that expressly survive termination of this Agreement," (3) in § 8.2 at 393, that "Seller hereby waives any right to recover . . . as a result of any conditions set forth in Sections [5.3.1] or [5.3.2] not being satisfied, except for the liquidated damages . . . ," and (4) in § 4.1.6 at 381, that certain due diligence obligations of the buyer, such as reimbursing the seller for costs to restore to the condition before the buyer's inspection, survive termination, and in § 11.5 at 401–402, that certain confidentiality obligations survive termination, and (5) for no other obligations that expressly survive termination of the purchase agreement). If the buyer damages the property during due diligence and fails to reimburse the seller for the cost of restoration, and the seller terminates the contract and receives the deposit as liquidated damages because the buyer fails to pay the purchase price at closing, does the seller have a surviving claim for the reimbursement? Or was the reimbursement obligation eliminated by the waiver described in clause (3) above?

145 See 2.1.2 above.

146 See 1.2 above.

satisfied with a right to pursue the buyer after closing and not be able to deprive the buyer of its right to buy the property.

As discussed in 1.2 and 2.1.1 above, the buyer's position articulated above takes pressure off both the buyer credit issue and the enforceability issues associated with the liquidated damages clause. Moreover, as discussed in 1.2.2 above, there is often very little for the buyer to breach before closing (and the due diligence obligations are usually covered, at least in part, by insurance, and both the due diligence obligations and the confidentiality obligations, at least insofar as they relate to the property, may not concern the seller after the closing).

If the buyer wants the right to force a closing as long as it proceeds to closing (even if the buyer is in material breach of another obligation under the purchase agreement), then it is not sufficient to limit the application of the liquidated damages clause to the buyer's wrongful failure to clause. The buyer will also want to eliminate any closing condition in favor of the seller based on the buyer's performance.[147] Even if the seller is willing to consider the buyer's approach, the seller may still have concerns: (1) it will want to make sure the buyer's liability for damages caused by a breach of its other obligations survives closing; (2) it may not want to give the buyer the right to force the closing if the buyer's representations and warranties are materially incorrect (e.g., if closing the transaction with the buyer would breach the OFAC rules); and (3) it may want the right to take the deposit if there is a material breach in the buyer's representations and warranties or if the buyer fails to post the additional deposit after notice and a cure period.[148]

4.3.3 Form. The Form:

- limits the seller's right to cancel and obtain the deposit to (x) the buyer's wrongful failure to close, or (y) the failure to post an additional deposit (if applicable) after notice and a cure period; and

- reserves the seller's rights as to buyer's liability for damages caused by any other buyer breach that survives the closing (and all such liability survives closing) or termination of the purchase agreement, subject to the survival and consequential/punitive damage limitations.

To avoid tainting the liquidated damages clause (or creating too large a price tag for a buyer breach of a representation and warranty), the Form does not give the seller the right to take the deposit for a material breach of the buyer's representations and warranties. It does, however, condition the seller's obligation to close on the accuracy of the buyer's representations and warranties in all material respects as of the scheduled closing date (so the seller cannot be forced

147 As discussed in 2.1.3 above, there is also the possibility that the seller may have a legal right (outside the contract) to cancel the purchase agreement, but any breach other than the wrongful failure to close might not be sufficient to justify such a cancellation. See 5 below for discussion of closing conditions.

148 The seller may not want to keep its property under contract if the buyer has not posted any required additional deposit. The initial deposit may not be adequate compensation for the buyer's wrongful failure to close. And even if the agreement gives the seller the right to claim the entire deposit (including the additional deposit, whether or not delivered), the seller may not want to chase an SPE buyer for money the buyer may never have.

to close if there is material breach of the buyer's representations and warranties). It also provides that the buyer's liability for damages caused by a breach of its representations and warranties survives a termination of the purchase agreement, and is not waived by the seller's proceeding with the closing with knowledge of the breach. The seller may, however, continue to be concerned about the buyer credit issue if the agreement is *terminated* for any reason that does not result in forfeiture of the deposit. In the Form, the buyer's liability that survives termination is for breaches of the buyer's representations and warranties and the usual culprits (e.g., due diligence indemnity, broker indemnity, confidentiality, and attorneys' fees). If for example, the buyer terminates during due diligence, and the deposit is refunded, then the seller may have no meaningful recourse even though buyer's liability for damages caused by a buyer breach (e.g., a failure to repair uninsured damage) survives termination, except to chase the distribution of the deposit (e.g., as a fraudulent transfer). As discussed in 1.2 above, this credit issue is rarely addressed (and it is not addressed in the Form) beyond the requisite insurance required during due diligence, which places additional emphasis on the importance of working with reputable counterparties.

5. CLOSING CONDITIONS BASED ON BREACH

Many, if not most, purchase agreements provide for closing conditions based on the absence of a breach by the other party:

> Typically, the agreement will state that each party's obligation to consummate the transaction is conditioned upon the accuracy of the other party's representations and warranties (often in all material respects) [and] the other party's performance of its covenants . . . .[149]

Such conditions effectively give a party a cancellation remedy if the other party breaches the purchase agreement (sometimes only when the breach is outstanding on the scheduled closing date). Many, if not most, purchase agreements with such default-based closing conditions provide that the remedy provisions control, or are not limited, when such a default occurs (or such cancelation right is exercised).[150] Given that the remedies can be handled in one place, why include conditions based on breaches (creating redundancy and an opportunity for inconsistency and

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[149] WARREN'S FORMS, *supra*, Ch. 20 [Agreements for the Purchase of Real Property], § 20.1[10] at 8, § 20.2.01 [Raw Land Purchase Agreement Form], §§ 11.1.1, 11.1.2, 11.2.1, 11.2.2 at 25–26; s*ee also, e.g.*, STEIN, *supra*, App. B, §§ 5.1.1, 5.1.2 at 385, and §§ 5.3.1, 5.3.2 at 386; SENN, *supra*, EX. 5-3, § 7.1(a) at 5-56 and § 7.2(a) at 5-57; SAFT, *supra*, § 9:26 [Form PSA] § 9.2(a)(i), (ii) and (iii) at 9-102-16, and § 9.3(a)(i), (ii), (iii) and (iv) at 9-102-17, § 9:28 [Office Building PSA], § 4.3(a)(i), (ii) and (iii) at 9-145, and § 4.3(b)(i), (ii) and (iii) at 9-146, § 9:30 [Multifamily PSA], §§ 9.8.1, 9.8.2, and 9.8.4 at 9-212.13–9-212.14, §§ 9.9.1, 9.9.2, and 9.9.4 at 9-212.14–9-212.15; CALIFORNIA CEB SALES BOOK, *supra*, § 4.174, § 6.1.3 at 4-176, and § 4.174, § 6.2.4 at 4-176. Sometimes breach-based closing conditions run in favor of the buyer only (perhaps for the reasons discussed in 4.3.2 above). *See, e.g.*, SENN, *supra*, App. 5A-A, Art. 11 at 5A-47; ARNOLD & KOVE, *supra*, § 8:6 [PSA for land and improvements], Art. 8(1) at 8-34.

[150] *See, e.g.*, STEIN, *supra*, App. B, §§ 5.2, 5.4 at 385-386; SAFT, *supra*, § 9:26 [Form PSA] § 13.3 at 9-102-27, § 9:28 [Office Building PSA], § 4.3(c) at 9-146, § 9:30 [Multifamily PSA], § 9.8 at 9-212.14, § 9.9 at 9-212.15, CALIFORNIA CEB SALES BOOK, *supra*, § 4.174, § 6.3 at 4-180.

error)? With limited exception,[151] the Form does not do so. Instead, it addresses the remedies for contract period breaches as follows:

5.1 **Buyer Contract Period Breach**. As discussed earlier, the Form does not give the seller a cancellation right (or a right to liquidated damages) based on the buyer's breach of a *covenant* short of the wrongful failure to close (or to fund an additional deposit after notice and a cure period). A cause of action for damages caused by a buyer contract period breach survives the closing and the seller should be able to pursue the buyer after closing: the buyer will have acquired the property (and therefore will no longer be an SPE with no assets other than the deposit). The seller does have a cancellation right (without the contractual right to take the deposit) if there is a material breach of the buyer's representations and warranties as of the scheduled closing date.

5.2 **Seller Contract Period Breach**. The Form provides that if there is *any* material breach by the seller as of the scheduled closing date, then the buyer may either (1) cancel the purchase agreement, get a refund of the deposit, and get reimbursement for its out-of-pocket costs up to a cap, or (2) specifically enforce the agreement.[152] Moreover, if specific performance is not available due to a Fraudulent/Bad Faith Seller Breach, and the buyer is not in material breach of its obligation to close, then there is no limit on the buyer's damages other than the exclusions from damages described in 8.5 below. Giving the buyer additional cancellation rights somewhat parallels other disparities that may be inherent in the sale[153]: (1) the buyer faces greater credit issues than the seller after closing (unless the seller provides credit enhancement such as a guaranty or escrow); (2) the buyer usually (in the author's experience) has a more limited right to damages than the seller if the purchase agreement is cancelled (with capped reimbursement rights as compared to liquidated damages) unless (in the case of the Form) specific performance is unavailable due to a Fraudulent/Bad Faith Seller Breach (and the buyer is not in material breach of its obligation to close); and (3) the buyer typically has fewer covenants than the seller. The Form also provides a closing condition that the seller's representations and warranties are accurate in all material respects as of the scheduled closing date. This closing condition parallels the corresponding closing condition benefiting the seller (regarding the buyer's representations and warranties). This closing condition, however, is needed only to address situations that don't involve a breach.

5.3 **Timing – Cure Rights**. As discussed in 3.2 and 4.1 above, (a) the cancellation remedy for a default is sometimes limited to defaults that exist on the scheduled closing date, (b) many purchase agreements require notice and an opportunity to cure before any remedies are

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[151] The Form does, however, include as a closing condition the truth of the representations and warranties of the other party, in all material respects, as of the scheduled closing date. This closing condition may not involve a material breach of the other party's representations and warranties; but it might, in which event the remedies provisions control in the event of a conflict.

[152] *See, e.g.*, SENN, *supra*, EX. 5-3, § 14.1 at 5-74, which allows the buyer to cancel the purchase agreement for a breach of seller's covenants in addition to seller's wrongful failure to close. *But compare* SENN, *supra*, App. 5A-A, § 14.2 at 5A-53, which allows the buyer to cancel the purchase agreement only for the seller's failure to close in accordance with the purchase agreement (this form is also missing any right to reimbursement of the buyer's costs).

[153] Of course, there is one major disparity that disadvantages the seller: during the contract period, the seller's property is tied up whereas the buyer's deposit, which is of far less value, is tied up. The Form assumes a relatively short contract period so that this concern is somewhat mitigated.

available after a default, and (c) some purchase agreements provide for both. Under the Form, the breaches that give rise to cancellation right must be outstanding on the scheduled closing date, but there is no right to notice and cure. Notice and cure rights often require extensions of the scheduled closing date. If such extensions may be accomplished without problems (e.g., timing restrictions on the payment of any existing financing) and the parties believe they are appropriate under the circumstances, then cure and extension rights may be added. A potential compromise is to have cure rights and corresponding extensions of the scheduled closing date, but not for closing obligations[154] and sometimes other defaults.[155] In the Form, this compromise would add minimal cure rights for the buyer (because the buyer's wrongful failure to close would not be eligible for a cure, the failure to fund an additional deposit already has a cure period, and the buyer typically has very few representations and warranties). For the sake of simplicity, default cure rights have not been included in the Form with the exception of a cure right prior to a forfeiture of the initial deposit when the additional deposit is not delivered on time. (There is also an implicit cure right associated with the buyer's default cancellation right because the seller must be in material breach on the scheduled closing date).

6. SURVIVAL

Real estate purchase agreements are typically drafted so that a *termination* or a *closing* is to occur on a particular date or within some finite period of time.[156] We will now consider what is meant when the purchase agreement states that something *survives* the closing or termination of the purchase agreement.

6.1 **Dual Purposes**? As indicated in 2.6.3 above, purchase agreements may include survival provisions for at least one of two purposes (or both): (1) to change the period of time during which a cause of action may be brought for a breach occurring prior to or at the time of termination or closing; or (2) to avoid extinguishing future obligations (i.e., ending the relevant obligatory period), such as confidentiality or indemnification obligations, by terminating or

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154 *See, e.g.*, SAFT, *supra*, § 9:30 [Multifamily PSA], § 11.6 at 9-212.18 ("The Closing Date shall be extended to the extent necessary to afford the defaulting party the full 10-day period within which to cure such breach, default or failure; *provided, however, that the failure or refusal by a party to perform on the scheduled Closing Date* (except in respect of a Pending Default by the other party) *shall be deemed to be an immediate default without the necessity of notice.*" (emphasis added)). *See also*, SAFT, *supra*, § 9:28 [Office Building PSA], § 10.3 at 9-164 ("[T]his Section 10.3 [providing for notice and five business day period to cure] (i) shall not apply to Purchaser's failure to deliver all or any part of the Deposit or the Purchase Price . . . or to a party's failure to make any deliveries required of such party on the Closing Date, and, accordingly, (ii) shall not have the effect of extending the Closing Date . . . ."), where the "accordingly" language is presumably intended to limit the language regarding extensions to closing obligations.

155 *See, e.g.*, SAFT, *supra*, § 9:26 [PSA], § 13.5 at 9-102.28–9.102-29 (excluding from the buyer's cure rights the buyer's obligations to fund the deposit and not to assign the PSA, in addition to closing obligations).

156 Some agreements reviewed by the author have had open closing dates (e.g., within 10 days after receipt of a loan assumption consent or zoning change with the loan assumption consent or zoning change being a condition to closing) and have failed to include an outside closing date. This may be dangerous. *See, e.g.*, 2 KLING & NUGENT, *supra*, § 15A.02 at 15A—4.1 ("If a condition is not satisfied [or waived], the closing does not occur. However, unless the termination section provides otherwise, the Agreement may very well live on indefinitely, or for a 'reasonable time.'" (footnote omitted)). The Form includes an outside closing date.

closing.[157] In the case of any particular provision (including a deed merger clause, as discussed in 2.5 above), the actual purpose may combine these concerns or may simply be intended to identify the exceptions to a statement (as discussed further in 7 below in the context of termination clauses) that one or both parties will have no further rights or obligations other than those that expressly *survive* (which may address not only the survival of damage (and possibly other) claims but also the preservation of certain obligations that either continue or first apply after termination). Unfortunately, few agreements reviewed by the author clearly distinguish between (or among) these varied purposes. Consider an obligation to maintain the confidentiality of the agreement (among other matters), which contains the following survival provision at the end:

> Each party's obligations under this [confidentiality] provision shall survive termination of this Agreement for a period of three (3) years.[158]

What is the purpose of this provision?

6.1.1 Avoid Extinguishment of Future Obligations: to continue the confidentiality obligations (i.e., to require each party to maintain confidentiality) for three years after termination (with no intent to modify the applicable statute of limitations)?

6.1.2 Alter the Statute of Limitation: to limit the statute of limitations for any breach of these confidentiality provisions *before termination* to three years after termination, if a lawsuit has not commenced by then (with no intent to extend the period during which confidentiality must be maintained)?

6.1.3 Hybrid: to continue the confidentiality obligations *and* to limit the statute of limitations (i.e., to require the parties to maintain confidentiality for three years after termination, and to limit the statute of limitations for a breach, *whether before or after* termination, to three years after termination if a lawsuit has not commenced by then)?[159]

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157 Sometime representations are required to continue (or effectively be remade) as of dates subsequent to the date originally made. One might view such continuation as a subset of this second category (although, in the author's experience, the word *survive* is not typically used for this purpose and the remaking of the representations is not usually after a closing or a termination).

158 WARREN'S FORMS, *supra*, § 20.2.02 [Agreement to Purchase Office Building Form] (2020), § 27 at 41.

159 *See, e.g.*, STEIN, *supra*, § 7.4, which contains a survival provision for indemnification provisions that appears intended to effect the third interpretation ("Article 7 shall survive the Closing indefinitely, except that Seller's indemnification of Purchaser pursuant to Section 7.1.1 shall terminate on the Survival Date (except with respect (i) the Pending Claims and (ii) specific claims . . . as to which Purchaser has instituted Action on or before the Survival Date)."). But the purpose is not always clear. *See, e.g., id*, § 11.10 ("Except where this Agreement expressly provides for a longer period, all obligations and liabilities of Seller and Purchaser under this Agreement shall expire on the Survival Date."), which could be read to have differing applications depending on the section to which it is being applied: (1) when applied to § 4.3 (which imposes obligations relating to the operation of the property prior to closing), there are no obligations after closing, so § 11.10 is presumably intended to limit the statute of limitations for a breach prior to Closing; but (2) when applied Article 10 (which sets forth the proration provisions, and provides in §10.14, that it "shall survive Closing" without specifying a survival period) many if not most of the obligations of Article continue to apply to the period after closing, so one might conclude that § 11.10 is also intended to establish the end of the post-closing period during which the parties must comply with Article 10.

In this particular example, the second possibility seems unlikely, but it may not be clear whether the first or third possibilities was intended. Under the first possibility, there is no limit on the statute of limitations, which may not be surprising in light of the fact that many (if not most) agreements (at least those reviewed by the author) have no such limits on *survival* after cancellation. But did the parties really intend to limit the period to which the obligation applies without also limiting the statute of limitations? And if they intended both, which is the third possibility, isn't it odd that the survival period (within which to bring a claim for a breach occurring after termination) is shorter the later the breach occurs (and in particular, that there would be no right to pursue a claim for a breach occurring at the very end of the three-year period)?

6.2 **Avoiding Extinguishment of Future Obligations**. It is common to include provisions to continue to impose existing (or to impose new) obligations during some period after a *termination* or *closing*.

6.2.1 After Closing. Purchase agreements often provide that certain obligations *survive* the closing with the purpose of requiring compliance *after closing.* As discussed in 2.6.3 above, the motivation behind such provisions may be concern over what might otherwise merge with the deed in the absence of such a survival provision. The need for such survival provisions is debatable when the parties clearly intend that the obligation apply after closing (but if there is a deed merger clause, there may be conflicting intent, so clarification may be helpful). Some examples:

- the obligation to re-prorate taxes when relevant tax bills are available.[160]
- indemnification obligations.[161]
- further assurance obligations.[162]
- access to records.[163]
- confidentiality obligations.[164]

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[160] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:33 [form PSA for shopping center], § 25(g) at 8-188 ("[T]axes shall be prorated on the basis of the best available information, and the parties agree to adjust any discrepancies in such prorations after the tax bills for such year are rendered. These provisions shall survive the delivery of the deed in this transaction."); SAFT, *supra*, § 9:26 [Form PSA], § 11.2(a) at 9-102.21.

[161] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:36 [PSA for hotel], Art. 12 at 8-216—82-217, which "Article shall survive Closing" (§ 12:4), including a reciprocal broker indemnity (§ 12.1), a seller indemnity for pre-closing matters (§ 12.2), a buyer indemnity for post-closing matters (§ 12.3) and a buyer due diligence indemnity (§ 12.3).

[162] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:38 [PSA for hotel], Art. 25 at 8-267, which specifies what provisions survive closing and includes Article 28 (Delivery of Documents After Closing; Instruments of Further Assurance); SAFT, *supra*, § 9:26 [Form PSA], § 8.7 at 9-102.13.

[163] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:38 [PSA for hotel], Art. 25 at 8-267, which specifies what provisions survive closing and includes Article 21 (Records); SAFT, supra, § 9:26 [Form PSA], § 8.6 at 9-102.12—9-102.13.

[164] *See, e.g.*, STEIN, *supra*, App. B, §§ 11.5.1, 11.5.2.

6.2.2 After Termination. As discussed in 2.6.3 above, the termination of a purchase agreement may extinguish future obligations. Also, as observed in 7 below, it is common for real estate purchase agreements to provide that the parties will have no further rights or obligations after termination subject to specified exceptions (often referred to as those that *expressly survive termination*). The parties commonly intend that some obligations continue to apply (or first arise) *after termination*. Consequently, purchase agreements often if not usually provide that certain obligations *survive* termination with the purpose of requiring compliance after termination. Many examples (including confidentiality and indemnification) were given in Section 4.2.1 in connection with a termination by the seller due to the buyer's default; those same examples often apply regardless of who terminates or the reason for termination.

6.3 **Modifying the Statute of Limitations**. Sometimes the parties to a real estate purchase agreement want to limit (or extend) the applicable statute of limitations for bringing a lawsuit on account of a breach.

6.3.1 After Closing. Rarely, in the author's experience, are the parties to a real estate purchase agreement willing to live with the applicable statute of limitations for a breach of the seller's representations and warranties if the closing occurs.[165] Although some contracts refer to continuing representations that are effectively remade at future dates, such remakes rarely occur after the closing of a purchase agreement. Consequently, survival provisions in the case of representations and warranties usually appear to be intended to be contractual modifications of the applicable statute of limitations (or contractual exceptions to the perceived application of the doctrine of merger).[166] The author has encountered varied approaches to survival *after closing* (and it is often not clear, except in the case of representations and warranties, whether all or a part of the reason behind the survival provision is to modify the statute of limitations or to avoid a merger):

- At one end of the spectrum, some agreements provide as a general rule that nothing survives closing with limited specified exceptions. [167]

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165 In the case of the seller, this is largely due to the fact that it wants a shorter period; and in the case of the buyer, it is sometimes due to a misunderstanding of the applicable merger rules. With the exception of title-related matters that might otherwise be merged with the deed, survival until the expiration of the applicable statute of limitations may be the result in some jurisdictions in the absence of any contractual modification of the survival limit. *See, e.g.*, Carey CA PSA Article, *supra*, § 5.3.1 at 40-41.

166 *See* 2.6 above.

167 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.07 [Office Building Purchase Agreement Form], § 17 at 39 ("Unless expressly provided for in this Agreement, no representations, warranties, terms or provisions contained in this Agreement shall survive the Closing and delivery of the Deed, or any termination of this Agreement." Express survival is limited to prorations and closing costs, due diligence indemnity, disclaimers and release, broker indemnity and confidentiality); SAFT, *supra*, § 9:28 [PSA for office building], § 11.18 at 9-170 ("Except as expressly provided herein, no representation, warranty, covenant or other obligation of any party hereunder shall survive the Closing or termination of this Agreement.").

- At the other end of the spectrum, some agreements provide as a general rule that *everything* survives closing with limited specified exceptions.[168] In the absence of such a general statement, the result may be survival until the expiration of the applicable statute of limitations, with the exception of title-related matters merging with (or being superseded and replaced by) the deed under common law.[169]

- Sometimes the general survival limits relate only to the *seller*'s obligations.[170]

- There is usually a specified survival limit for the *seller's representations and warranties.* [171]

- Sometimes the survival limit for the seller covers *all the seller's obligations* (and not merely the seller's representations and warranties). [172]

- Sometimes there is a survival limit for representations and warranties that benefits both the seller and the buyer. [173]

- Sometimes there is a survival limit for all obligations that benefits both the seller and the buyer. [174]

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168 *See, e.g.,* WARREN'S FORMS, *supra*, § 20.2.03 [Land Purchase Agreement Form], § 8.10 at 58 ("The provisions of this Agreement shall not merge with the delivery of the Deed but shall, except as otherwise provided in this Agreement, survive the close of escrow."); ARNOLD & KOVE, *supra*, § 8:33 [PSA for shopping center], § 37 at 8-192 ("The terms and conditions of this Contract shall not merge into the execution and delivery of the Warranty Deed, but rather shall survive the execution and delivery of said Deed and be fully enforceable thereafter.").

169 *See, e.g.*, 2.6.3 above.

170 *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:5 [Plain Language PSA – NY Form], § (12) at 8-28 ("Acceptance of a deed by the Buyer shall be deemed to be full performance by the Seller, except as to the obligations of this Contract which are herein stated to survive the delivery of the deed."); NYC PSA FORM, *supra*, § 16.01 ("Except as otherwise provided in this contract, no representations, warranties, covenants or other obligations of Seller set forth in this contract shall survive the Closing, and no action based thereon shall be commenced after the Closing.").

171 *See, e.g.*, SAFT, *supra*, § 9:30 [Multifamily PSA], § 11.16 at 9-212.20 ("Section 5.1 [Representations by Seller] shall survive the Closing but written notification of any claim arising therefrom and lawsuit must be received by Seller and filed within nine (9) months of the Closing Date . . . ."); CALIFORNIA CEB SALES BOOK, *supra*, § 4.713 [Form: Representations and Warranties], § 5.4 at 4-174 ("Seller's warranties and representations . . . with respect to the Property will survive for __[e.g., 6] __ months after the Closing Date . . . ."); SENN, *supra*, EX. 5-3, § 8.2 at 5-66 ("The representations and warranties made in Section 8.1 [Seller's Representations] shall survive the Closing for the Representation [sic] Survival Period." There is no corresponding provision for the buyer's representations and warranties.).

172 *See, e.g.*, SAFT, supra, § 9:31 [Mall PSA], § 8.1.12 at 9-258 ("Seller's liability for pre-Closing Date liabilities and obligations shall survive for a period of 12 months from the Closing Date.").

173 *See, e.g.,* SAFT, *supra*, § 9:28 [PSA for office building], § 5.4 at 9-150—9-151 ("All representations and warranties contained in Sections 5.1 [Representations of Seller] and 5.2 [Representations of Purchaser] . . . shall survive Closing and the delivery of the Deed for a period of six (6) months . . . .").

174 *See, e.g.,* STEIN, *supra*, App. B, § 11.10 at 402 ("Except where this Agreement expressly provides for a longer period, all obligations and liabilities of Seller and Purchaser under this Agreement shall expire on the Survival Date.");

- The end results for each party may vary. Sometimes a party's obligations may not survive the closing because the general rule stated in the purchase agreement is that nothing survives and there is no express statement that the party's obligations survive. Sometimes the buyer's obligations may survive, but some or all of the seller's obligations may not, because of the interplay of various provisions (e.g., a statement that acceptance of the deed constitutes full performance by the seller or a release of the seller's obligations effective at closing that doesn't exclude its obligations under the purchase agreement).[175]

6.3.2 After Termination. A real estate purchase agreement might also provide that liability for certain obligations *survive termination* of the purchase agreement with the purpose of limiting or extending the applicable statute of limitations for a breach.[176] However, the need (of the beneficiary of an obligation) to provide for survival of a claim for an existing breach may not always be clear (because termination might not extinguish the claim and the statute of limitations may provide adequate time to pursue the claim). The author suspects that the primary reason that obligations are stated to survive termination is due to the relatively common provision (discussed in 7 below) that the parties will have no further rights or obligations except those that expressly *survive* termination of the agreement. Consider, for example, a purchase agreement that provides that the buyer's obligation to notify the seller before contacting any governmental agencies (regarding the environmental condition of the property) *survives* the termination of the purchase agreement.[177] This notification obligation is not likely to be relevant after termination.

6.4 **Duration**. Another aspect of survival that may give rise to confusion is the duration of the survival.

6.4.1 Unspecified Duration. In real estate purchase agreements reviewed by the author in which there are survival provisions intended to extend the duration of an obligation, there is usually no limit on the extension.[178] And there is usually no stated limit

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SENN, *supra*, App. 5A-A, Art. 21 at 5A-58 ("The representations, warranties, covenants and agreements of the parties shall survive the Closing and the delivery of the Deed for a period of six (6) months . . . .").

175 *See, e.g.*, CALIFORNIA CEB SALES BOOK, *supra*, § 4.713 [Form: Representations and Warranties], § 5.6 at 4-174–4-175 (which contains a release of any and all liability of the seller "in any way growing out of or connected with this Agreement . . . except matters arising from Seller's fraud or intentional misrepresentation [and an exception for representations that survive for a specified period]." By contrast, § 4.718 [Form: General Provisions], § 10.5 at 4-197 states that "This Agreement, each provision of it, and all warranties and representations in this Agreement will survive the Closing . . . .").

176 This purpose seems most obvious in the case of representations and warranties that are stated to survive termination. *See, e.g.*, SAFT, *supra*, § 9:26 [Form PSA], § 15.1 at 9-102.31—9-102.32 ("[I]f this Agreement is terminated . . . , the representation and warranty in Sections 7.2(d) [sic] shall survive such termination for a period commencing on the date of such termination and expiring on the date which is ninety (90) days after such termination.").

177 *See, e.g.*, SAFT, *supra*, § 9:17 [Condition of Property – Sample Provision], § 1.3 at 9-60.

178 This is common in the author's experience in connection with due diligence indemnities that are stated to survive closing. *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:36 [PSA for hotel], Art. 12 at 8-216—8-217.

after termination for any purpose.[179] Does the obligor intend to remain obligated for an indefinite period and to be subject to the applicable statute of limitations for any particular breach? From the standpoint of the beneficiary of the obligation, this may seem like a good thing. But, as discussed in 2.6.3 above, there is some question as to whether such unlimited obligations would survive a court challenge. And why leave this issue to the courts? Similar issues arise when the cause of action for a breach prior to closing or termination survives the closing or termination for an unspecified period of time (although the presumption may be that the applicable statute of limitations controls) or is stated to survive indefinitely.

6.4.2 Specified Duration. As noted earlier, there is typically a specified duration for pursuing a breach of the seller's representations and warranties *after closing*. There may also be a specified duration for pursuing a breach of other obligations that are stated to survive *the closing*.[180] What happens when you reach the end of the survival period? Some agreements provide that in order to preserve a claim, a lawsuit must have been commenced;[181] some merely require that written notice has been given.[182] Some require both notice and a lawsuit within the survival period;[183] but some provide for an extended period for the filing of the lawsuit.[184] Most agreements reviewed by the author are silent.[185] This may be particularly

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179 *See, e.g.*, STEIN, *supra*, App. B; SENN, *supra*, EX. 5-3 and App. 5A-A, In these three purchase agreement forms, for example, there are numerous statements that certain provisions or obligations survive the termination of the purchase agreement, but the author did not see any survival limit after termination.

180 *See, e.g.*, STEIN, *supra*, App. B, § 11.10 at 402 ("Except where this Agreement expressly provides for a longer period, all obligations and liabilities of Seller and Purchaser under this Agreement shall expire on the Survival Date.").

181 *See, e.g.*, STEIN, *supra*, App. B, § 3.4 at 379 ("Any Action on any such representation or warranty pursuant to Section 7.1 shall be instituted on or before the Survival Date.").

182 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.08 [Shopping Center Purchase Agreement Form], § 6.14 at 141 ("The representations and warranties made in this Agreement shall survive the Closing, but written notification of any claim arising therefrom must be sent by the party making such claim within two hundred seventy (270) days after the Closing Date or such claim shall be forever barred, and the other party shall have no liability with respect thereto.").

183 *See, e.g.*, SAFT, *supra*, § 9:26 [Form PSA], § 11.16 at 9-212.20 ("The representations and warranties set forth in this Agreement . . . shall survive the Closing but written notification of any claim arising therefrom and lawsuit must be received by Seller and filed within nine (9) months of the Closing Date (the 'Survival Period') or such claim shall be forever barred and Seller shall have no liability with respect thereto.").

184 See, e.g., SENN, *supra*, EX. 5-3, § 8.2 at 5-66 ("No claim for a breach of any representation or warranty of Seller shall be actionable unless . . . written notice containing a description of the specific nature of such breach shall have been given by Buyer to Seller prior to the expiration the Survival Period [sic] and an action shall have been commenced by Buyer against Seller within thirty (30) days after the termination of the Survival Period . . .); *see, e.g.*, PA. PSA FORM, *supra*, § 23.2 at 18 ("As to any obligations, agreements, indemnities, representations, warranties and covenants which are expressly stated to survive the Closing for some period of time, written notice of the alleged violation or breach of any such obligation, etc. must be delivered to the other party prior to the expiration of any such period and litigation thereon must be commenced within six (6) months after the giving of such notice . . ."); WARREN'S FORMS, *supra*, § 20.2.07 [Office Building Purchase Agreement Form], §§ 5.4 at 115, 5.7 at 116.

185 *See, e.g.*, SAFT, supra, § 9:31 [Mall PSA], § 7.5 at 9-255 ("The representations and warranties set forth in this Agreement shall survive the Closing for a period of one (1) year (365 days) (the 'Survival Period')."); WARREN'S FORMS, *supra*, § 20.2.01 [Raw Land Purchase Agreement Form], § 19.4 at 30 ("Unless otherwise specifically provided in this Agreement, the representations and warranties of the parties shall survive for a period of six (6) months after Closing."); ARNOLD & KOVE, *supra*, § 8:36 [PSA for hotel], § 14.2 at 8-218 ("Such representation and warranties shall survive for a period of [number of months] days after the date of Closing."); SENN, supra, App. 5A-A, Art 21 at 5A-58 ("The representations, warranties, covenants and agreements of the parties shall survive the Closing and the

confusing in the context of an indemnification obligation: if an indemnification obligation is stated to survive the closing for a specified period with no further clarification,[186] what does it mean? That a lawsuit for a breach must be brought prior to the expiration of the period? Some purchase agreements so provide.[187] But is that what is intended? What if there has been no breach and a claim is being indemnified when the survival period ends? This is another example of the confusion associated with the varied unstated purposes of a survival period. In this case, the indemnification obligation has presumably been extended but the extension may not make sense if it doesn't continue beyond the survival period for claims as to which the indemnification process has begun.

6.4.3 The Form. The Form contains a reciprocal survival provision: as a general rule, each party's liability for damages caused by a breach of its obligations (x) survives the closing until a specified survival limit unless otherwise specified, and (y) does not survive termination unless otherwise specified. In an effort to avoid confusion, the Form includes the following features:

- *survival* concepts are limited to the survival of liability for damages caused by a breach (and specifically, the period of time the cause of action for such damages may be preserved);

- if an obligation (e.g., confidentiality or an indemnity) is intended to continue to apply after Closing or a termination, then the obligation *continues* (rather than *survives*) or is included within the definition of Post-Closing Obligations or Post-Termination Obligations, as applicable;

- a base survival limit is to be established as one of the deal terms (although certain breaches, such a breach of the re-proration obligations, have different survival periods);

- the survival limits may be extended under certain circumstances (e.g., when notice of a breach is given with the survival period and a lawsuit is brought within a certain period of time);

- indemnities are addressed separately (based on the timing of the demand for indemnification, whether the demand is rejected in writing within a certain time period, and if it is so rejected, whether suit is brought within a certain time period); and

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delivery of the Deed for a period of six (6) months, provided however, the representations and warranties contained in Sections 7.18, 7.19, 7.2.0, and 9.2 shall not expire.").

186 *See, e.g.*, SAFT, *supra*, § 9:12 [Indemnification provision – Sample Provision], § (c) at 9-48 ("The provisions of this Subsection shall survive the Closing for the period set forth in Section [designate section] above.").

187 *See, e.g.*, STEIN, *supra*, App. B, § 7.4 at 390 ("Seller's indemnification of Purchaser pursuant to Section 7.1.1 shall terminate on the Survival Date (except with respect to (i) the Pending Claims [listed on a schedule to the purchase agreement] and (ii) specific claims under Section 7.1 as to which Purchaser has instituted Action [i.e., a legal proceeding] on or before the Survival Date).").

- title covenants do not survive the closing.

The survival provisions may vary due to the limitations, as discussed in 2.6.3, imposed by the governing law.

7. POST-TERMINATION REMEDIES.

What happens if the purchase agreement is terminated? Some purchase agreements provide that upon termination, they are *void*. [188] As discussed in 2.6.4 above, such language may not be intended.[189] In the author's experience, *voiding* language is not very common, but it still appears from time to time. More common in the author's experience is a provision stating that neither party will have any further rights or obligations other than those that *expressly survive termination* [190] (which is sometimes replaced with an exception for what is *otherwise expressly provided*[191]). Often, such statements are repeated in relation to various termination rights contained in the agreement.[192] As discussed in 6 above, the obligations that are stated to *survive* may be obligations

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[188] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:33 [form PSA for shopping center], § 27 at 8-188 ("[A] default on the part of Buyer will allow Seller to retain Earnest Money as liquidated damages and void this Contract . . .").

[189] *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:41 [form PSA for sale of land for construction of office building], § 9.1k(4) at 8-299 ("[T]he failure to fulfill any of the warranties and representations specified herein regarding the easement in any manner whatsoever shall void this Agreement . . ."). Yet the same form includes indemnities regarding brokers (11.2 at 8-301) and due diligence (15.1 at 8-302), which the parties presumably do not want to eliminate upon termination.

[190] *See, e.g.*, SENN, *supra*, EX. 5-3, §4.2(a) at 5-45 ("Upon any election by Buyer made in accordance with this Section 4.2(a) to terminate this Agreement, the Escrow Agent shall return the Deposit to Buyer and neither party shall have any further obligations under this Agreement (except those provisions hereof which are expressly stated to survive termination)."); STEIN, *supra*, App. B, § 2.2.2.1 at 374 (". . . this Agreement shall automatically terminate and neither party to this Agreement shall thereafter have any further rights or liabilities under this Agreement other than those that expressly survive termination of this Agreement."); SAFT, *supra*, § 9:26 [Form PSA] § 13.3 at 9-102.27 ("In the event of the termination of this Agreement pursuant to Section 13.1 or Section 13.2 [which list over 6 termination rights] this Agreement shall thereafter become void and have no effect, without any liability on the part of any Party other than . . . such provisions in this Agreement which expressly survive termination of this Agreement."); WARREN'S FORMS, *supra*,§ 20.2.02 [Agreement to Purchase Office Building Form] (2020), § 4(c) at 34 ("…this Agreement shall terminate without any further right or remedy in favor of either party against the other except for liabilities, rights and remedies which survive Closing or termination as provided in this Agreement."); MA. PSA FORM, *supra*, § 4.1 at 4 (". . . terminate this Agreement, in which event the Deposit shall be reimbursed to Buyer and neither party shall have any further obligations hereunder, except for those that expressly survive the termination of this Agreement."); ARNOLD & KOVE, *supra*, § 8:2 [short form PSA for complex commercial transactions], § 14.2 at 8-18 (". . . this Agreement shall terminate and the parties hereto shall have no further rights, duties, or obligations hereunder except for such rights, duties, or obligations that expressly survive such termination."), but it should be noted that there is no express statement in such short form PSA that any right, duty or obligation survives termination.

[191] *See, e.g.*, MA. PSA FORM, *supra*, which uses the survival exception formulation in § 4.1 and the more generic exception formulation in §§ 4.4.3, 4.4.4. 6.2 and 7.

[192] See, *e.g.*, STEIN, *supra*, App. B, §§ 2.2.2.1 at 374 [failure to timely deliver the initial deposit], 4.1.1 [due diligence period] at 379, 4.2.3 [title objections] at 382, 4.2.5 [title objections] at 382, 8.2 [Purchaser's Default] at 393, 8.3 [Seller's Default] at 393, 9.2 [Purchaser Right to Terminate for Casualty or Condemnation] at 394; SENN, *supra*, Exhibit 5-3; WARREN'S FORMS, *supra*,§ 20.2.02 [Agreement to Purchase Office Building Form] (2020). Some purchase agreements define the surviving obligations (and then, using the defined term, have similar repetition). *See, e.g.*, SENN, *supra*, App. 5A-A, § 5.3 at 5A-34—5A-35 ("Purchaser shall have the right to terminate this Agreement . . . whereupon, this Agreement shall be of no further force and effect, at law or in equity, and neither party shall have any further rights against or obligations to the other hereunder except for Purchaser's obligations arising under Sections 5.4 [Purchaser's Inspection and Indemnification], ARTICLE 16 [Brokerage] and ARTICLE 17

that are intended to *continue* to apply after termination or that are not forgiven (for the pre-termination period) by the termination or both.[193] In any event, most purchase agreements reviewed by the author do not say much about the remedies available for such surviving obligations. But some of the limitations (discussed in 8 below) that may apply to post-*closing* remedies may also apply to post-*termination* remedies (e.g., the no-insider recourse provisions and the damage exclusions). The Form does not deviate from this common approach.

8. POST-CLOSING REMEDIES.

Once the closing occurs, the parties have usually realized the primary benefits of their bargain. But the buyer may still be concerned about receiving *all* the benefits for which it bargained. By contrast, absent seller financing, an earnout or other continued entanglement after the closing, the seller may have its cash and simply be looking for a clean break. This tension is reflected in several provisions that apply to the parties' post-closing remedies, such as: (1) limitations on claims outside the purchase agreement (as discussed in 2.5); and (2) various limitations on (and some expansions of) available remedies (some of which were discussed in 2.6), especially the buyer's remedies, including:

- no (or limited) recourse against insiders[194];
- knowledge waivers (anti-sandbag vs pro-sandbag protection);
- survival provisions[195];
- materiality thresholds and caps; and
- certain damage exclusions.[196]

But generally in the author's experience, there are no specific remedies identified for this period. An occasional exception to this general rule is a post-closing indemnity. Survival is discussed in 6 above; the other subjects identified above are discussed below.

8.1 **Limitations on Extra-Contractual Claims**.

[Confidentiality] (the '**Surviving Obligations'**)."); other termination rights result in "no further liability hereunder except with respect to the Surviving Obligations" or similar language that preserves the Surviving Obligations. §§ 6.2(b), 6.3 [termination due to objectionable title exceptions]; §14.1(b) [termination due to buyer's default]; § 14.2(b)(i) [termination due to seller's default]; §§ 15.2, 15.3 [termination due to casualty or condemnation]. Perhaps the omission of Seller's obligations in the definition was inadvertent.

193 See, *e.g.*, SAFT, *supra*, § 9:12 [Indemnification provision – Sample Provision], § (c) at 9-48 ("The provisions of this Subsection shall survive the Closing for the period set forth in Section [designate section] above.").

194 An *insider no-recourse clause* typically applies at all times (including before closing), but the buyer's right to damages is often limited to the period after closing.

195 The survival provisions also apply to the period after *termination*.

196 The damage carve-outs often apply at all times, but the buyer's right to damages if often limited to the period after closing.

8.1.1 Exclusive Remedy Clauses. Most real estate purchase agreements reviewed by the author do not provide for exclusive remedies after the closing; but, as noted in 8.6 below, some real estate purchase agreements provide that indemnification is the exclusive post-closing remedy. By contrast, in corporate acquisitions, indemnification is usually stated to be the exclusive remedy.[197]

8.1.2 Integration/Merger Clauses. Most contracts, including real estate purchase agreements, encountered by the author include an *integration clause* (which, as noted in 2.5 above, may also be called a *merger clause*, although the latter term may have another meaning).[198] But in the author's experience, this clause rarely gets much attention despite the varying treatment in different jurisdictions discussed in 2.5 above. To mitigate against the possibility that the clause might not be conclusive (as reflecting the intent of the parties), the integration clause in the Form adds language stating that no extrinsic evidence may be introduced in any proceeding to interpret the purchase agreement. At least one appellate court (in a jurisdiction with a relative weak parol evidence rule) has upheld such a clause.[199]

8.1.3 Disclaimers. As noted in 2.5, disclaimers in real estate purchase agreements typically take the form of an *"as-is" clause*. In the author's experience, such clauses are very common, even in deals with substantial representations and warranties, and used in an attempt to exclude any representations that are not set forth in the purchase agreement. The Form contains an *"as-is" (disclaimer) clause*, which, as is typical in the author's experience, is separate from the *integration clause*.

8.1.4 Non-reliance clauses (as to other promises). *Non-reliance clauses* appear in many of the sample purchase agreements reviewed by the author for this article. They may state that (1) the buyer has relied solely on its own investigations without any representation or warranty not set forth in the purchase agreement,[200] (2) the buyer has not relied on any representation or warranty not included in the purchase agreement,[201] or (3) both.[202] The disclaimer in the Form includes anti-reliance language of the third variety.

8.1.5 Release. As is typical in the author's experience,[203] the Form includes a release of the seller, but no similar release for the buyer. The release is effective as of the

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197 *See, e.g.*, Eva Davis, *The Looming Specter: Post-Closing Fraud Claims in Private Company M&A Litigation*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (July 19, 2017) ("[T]he parties typically include an 'exclusive remedy' provision stipulating that indemnification pursuant to the contractual framework is the parties' sole recourse in the event of a breach.").

198 *See, e.g.*, 6 CORBIN ON CONTRACTS, *supra*, § 25.15 at 126 ("Typically, modern contracts will almost automatically include a merger clause.").

199 *Hot Rods, LLC v. Northrop Grumman Sys. Corp.*, 242 Cal.App.4th 1166 (2015) (upholding integration clause with express prohibition of extrinsic evidence in a judicial reference)

200 *See, e.g.*, SENN, *supra*, § 5.04[B][1] at 5-14–5-17, EX. 5-3, § 6 at 5-53–5-55.

201 *See, e.g.*, SENN, *supra*, § 5.04[B][1] at 5-14–5-17, App. 5A, §7.18 at 5A-42.

202 *See, e.g.*, STEIN, *supra*, App. B, § 2.3.1 at 374;

203 *See, e.g.*, STEIN, *supra*, App. B, § 2.3.2 at 374; SENN, *supra*, § 5.04[B][1] at 5-14–5-17, EX. 5-3, § 6 at 5-53–5-55.

Closing, although some releases encountered by the author are effective when the purchase agreement is signed.[204] Much time can be spent negotiating whether and to what extent there should be exceptions to the release beyond the seller's express obligations under the purchase agreement and the closing documents.[205] Buyers may say, how can you expect me to agree at signing that the seller will be released at closing for a tort (e.g., gross negligence or willful misconduct) the seller might commit between signing and closing? Sellers may respond that they are not signing up for any liability other than what is in the agreement and they do not want to get sued over perceived promises by someone on the seller team that are not set forth in the purchase agreement. In the author's experience, buyers typically don't fight this point, perhaps because (as discussed in 2.5.1) the release may not be effective for a serious tort. But buyers may press (1) to make clear that the buyer may interplead the seller if the buyer is sued for bodily injury occurring at the property before closing and (2) to carve out *fraud*. The Form concedes the former point (because the seller's insurance rather than the buyer's insurance should cover such a contract period bodily injury claim). But the latter point is more difficult. Many sellers will resist the breadth of a *fraud* carve-out in the related context of thresholds and caps and when they agree, they may limit the carve-out to *intentional breaches of the contract representations*.[206] In the context of a release that already carves out the express representations and other obligations under the agreement, such a carve-out may not add anything; but it may focus the buyer on the adequacy of the existing representations. Some buyers will say they need a catchall representation that the seller has disclosed all material information relating to the property that is known to the seller. The Form does not add such a representation. But, as a compromise, the Form excludes from the release the seller's fraudulent withholding of material information from the due diligence materials (not known or reasonably accessible to the buyer prior to the DD Disclosure Deadline) with an intent to deceive the buyer (which, as discussed in 3.3.7 above, is part of the definition of a Fraudulent/Bad Faith Seller Breach).

8.2 **No Recourse Against Insiders**. Insiders are often beneficiaries of releases[207] and indemnities[208] in favor of the party with which they are affiliated. But such releases and indemnities are often not intended to provide protection for a breach by the released party of the purchase agreement. As discussed in 2.6.1, some agreements also include an *insider no-recourse*

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204 *See, e.g.*, *id.*; WARREN'S FORMS, *supra*, § 20.2.03 [Comprehensive Land Purchase Agreement Form], § 3.6 at 50 ("Except with respect to any claims arising out of any breach of . . . this Agreement, Buyer, . . . hereby releases and forever discharges Seller, . . . from . . . any claims and demands arising under or in any way related to the Sale Property through the Closing."). Buyers may think it is unfair to waive a future tort, and doing so may undermine the effectiveness of the release. For example, in California, an intermediate appellate court recently stated that Cal. Civ. Code § 1668 "prohibits exculpation from future torts." *Variel*, *supra* at 152.

205 Some purchase agreements do not mention the closing documents in the exclusions from the release. *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.03 [Comprehensive Land Purchase Agreement Form], § 3.6 at 50. And some limit the exclusions to representations and warranties. *See, e.g.*, SAFT, *supra*, § 9:28 [Office Building PSA], § 6.2 at 9-153, and definition of "Excepted Claims" at 9-136. On the other hand, some releases are limited to environmental matters. *See, e.g.*, MA. PSA FORM, *supra*, § 4.6; *see also* SENN, *supra*, App. 5A-A, § 7.19 at 5A-42 (covenant not to sue for environmental matters); SAFT, *supra*, § 9:26 [PSA], § 6.4 at 9-102.2 (release for environmental matters and violations of law). And some purchase agreements have no release at all. *See, e.g.*, NYC PSA FORM, *supra*; PA. PSA FORM, *supra*.

206 *See, e.g.*, West Fraud Article, *supra*, 1052 at n.10.

207 *See, e.g.*, STEIN, *supra*, App. B, § 2.3.2 at 374-375; SENN, *supra*, Exhibit 5-3, § 6 at 5-52—5-56.

208 *See, e.g.*, STEIN, *supra*, App. B, § 7.1 at 389-390; SENN, *supra*, Exhibit 5-3, § 5.2 at 5-50.

provision to protect insiders for any claim under the purchase agreement.[209] In the author's experience, many parties do not request (and are willing to forgo) an insider no-recourse provision (being willing to rely instead on the statutory protections from using a limited liability entity). If drafted to protect only one of the parties, the other party will often ask to make this provision reciprocal. The Form includes such a provision benefitting the insiders of both parties with carve-outs for (x) the obligations of a guarantor of the purchase agreement, if the guaranty alternative (discussed in 1.1.2) has been chosen, (y) the obligation of a direct or indirect owner of the seller to refund its share of a wrongful distribution of sale proceeds, if the tracing alternative (discussed in 1.1.4) has been chosen, and (z) a Fraudulent/Bad Faith Seller Breach in which the insider intentionally participated.

8.3 **Anti-Sandbag vs Pro-Sandbag Protection**. As discussed in 2.6.2 above, the common practice regarding sandbag provisions (i.e., whether the buyer's closing with knowledge of fraud or a breach of a misrepresentation waives the breach) may vary considerably in commercial real estate purchase agreements, on the one hand, and corporate acquisition agreements, on the other hand. In commercial real estate purchase agreements, there is often an express waiver (anti-sandbag protection) under these circumstances.[210]

8.3.1 Varied Approaches. The author has encountered varied approaches to so-called *anti-sandbag* protection in real estate purchase agreements:

- Many purchase agreements provide that the buyer waives any claim for a breach of a representation and warranty of the seller if the buyer closes with knowledge of the breach, but there is no corresponding waiver by the seller if it closes with knowledge of a buyer breach.[211] Sometimes the waiver is

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209 *See, e.g.*, PA. PSA Form, *supra*, § 25.4 at 19 ("None of the directors, officers, employees, shareholders, partners or agents of Seller or any subsidiary or affiliate of Seller shall have any personal obligation or liability hereunder, and Purchaser shall not seek to assert any claim or enforce any of its rights hereunder against any directors, officers, employees, shareholders, partners or agents of Seller or of any subsidiary of affiliate of Seller or against any other person, partnership, corporation or trust, as principal of Seller, whether disclosed or undisclosed."); *See, e.g.*, SAFT, *supra*, § 9:24 [Exculpation – Sample Provision] at 9-79 (". . . In any event, none of the members or managers of Seller nor any of the directors, officers, employees, shareholders, partners or agents of any of the a member or manager of Seller nor any other person, partnership, corporation or trust, as principal of Seller, whether disclosed or undisclosed (collectively, "Seller Exculpated Parties") shall have any personal obligation or liability hereunder, except as permitted by operation of law, and Purchaser shall not seek to assert any claim or enforce any of its rights hereunder against any Seller Exculpated Party, except to the extent of sales proceeds actually received by such Seller Exculpated Parties.")

210 *See, e.g.*, STEIN, *supra*, § 2.49 ("Increasingly, sellers and buyers . . . commonly agree that a buyer cannot sue the seller after closing if the buyer had knowledge of the breach of a representation or warranty before the closing.").

211 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.07 [Office Building Purchase Agreement Form], § 5.4 at 115 ("No claim for a breach of any representation or warranty of Seller under this Agreement or any other instrument delivered to Purchaser under or pursuant to this Agreement shall be actionable or payable if the breach in question results from or is based on a condition, state of facts or other matter which was known to Purchaser prior to Closing."); SENN, *supra*, EX. 5-3, § 8.1 at 5-66 ("If Buyer acquires the Property with knowledge of an untrue or incorrect representation or warranty, then upon the Closing, Buyer shall be deemed to have fully and unconditionally waived and released any and all claims, actions and causes of action whatsoever with respect to such untrue or incorrect representation or warranty.").

accomplished by an automatic modification of the seller's representations to reflect the buyer's knowledge.[212]

- Some purchase agreements also provide that a breach of seller's representations and warranties is waived if the buyer had knowledge of the breach as of the end of a free look period (i.e., a due diligence period during which the buyer may terminate the purchase agreement for any reason or no reason) yet failed to terminate the purchase agreement.[213]

- Some purchase agreements provide that the buyer waives any claim for *any seller breach* (not merely a breach of a representation and warranty) if the buyer closes with knowledge of the breach).[214]

- Some purchase agreements provide for a waiver *by either party* if it closes with knowledge of a breach of a representation by the other party.[215]

- On the other hand, some agreements provide there is no waiver of a breach of a representation and warranty regardless of knowledge.[216]

8.3.2 The Form. The Form takes the following positions:

- *Closing Waiver – Representations and Warranties*. The Form provides a waiver of the seller's breach of a representation and warranty if the buyer closes with knowledge of the breach (with the exception of a Fraudulent/Bad Faith Breach). If the breach is material, the buyer can

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212 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.08 [Shopping Center Purchase Agreement Form], § 6.4 at 141 ("[I]f prior to Closing Purchaser acquires knowledge of facts or circumstances that render any of such representations or warranties inaccurate or untrue in any respect, but Purchaser nevertheless elects to close, the applicable representation or warranty shall be automatically modified without the necessity of further acts by the parties to reflect such facts or circumstances."). No corresponding provision benefits the buyer.

213 *See, e.g.*, STEIN, *supra*, App. B, § 3.3.1 at 378 (which accomplishes the same result by automatically modifying the seller's representations and warranties to reflect the buyer's knowledge).

214 *See, e.g.*, SENN, *supra*, EX. 5-3, § 14.1 at 5-74 ("Buyer's election to proceed with the Closing with actual knowledge of a breach or default by Seller hereunder as of or prior to the Closing (including without limitation a breach of any representation or warranty of Seller herein) shall conclusively constitute Buyer's waiver of any and all claims against Seller on account thereof."). No corresponding provision benefits the buyer.

215 *See, e.g.*, STEIN, *supra*, App. B, §§ 3.3.3 and 3.3.4 at 378–79; for reciprocal waivers through automatic modification, *see* SAFT, *supra*, § 9:26 [Form PSA], § 7.1 at 9-102.6, and § 7.2 at 9-102.8.

216 In the author's experience, when such pro-sandbag provisions appear in real estate purchase agreements, they may appear weaker because they refer to investigations rather than knowledge (sometimes referring to "investigations that are actually made or that could have been made", although no published examples of this formulation were located by the author in the forms reviewed for this article). *See, e.g.*, ARNOLD & KOVE, *supra*, § 8:6 [PSA for land and improvements], Art. 5 at 830 ("which representations and warranties shall survive the Closing regardless of what investigations Buyer shall have made with respect thereto prior to the Closing."). Some formulations could be construed merely to preclude the imputation of constructive knowledge. In any event, the primary issue is whether justifiable reliance is necessary to enforce a claim after closing. Reliance is even more of an issue with tort claims; and justifiable reliance may be challenged even if the buyer did not know of the breach but would have known of the breach had it conducted sufficient investigation. *See, e.g.*, 1 FRIEDMAN AND SMITH, *supra*, § 8:1.13 at 8-11–8-16.

terminate and get reimbursement up to a cap. As discussed in 4.3.2, there is no similar waiver if the seller closes with knowledge of a breach of the buyer's representations and warranties. Liability for damages caused by a breach of such representations and warranties survives regardless of the seller's knowledge.

- *Closing Waiver – Covenants*. The Form does not provide protection for either party if the other party closes with knowledge of a breach of a covenant. In the case of liability for a contract period breach of the buyer's covenants, avoiding a waiver may be important to the seller: as discussed earlier, the seller does not have a contractual right to stop the buyer from proceeding with the closing by reason of most breaches. It may also be important to the buyer in light of the limited remedies available to the buyer. For example, if the seller fails to deliver some of the closing documents or fails to obtain the buyer's consent to a new lease, should the buyer's knowledge of the breach waive the seller's responsibility?

- *Due Diligence Waiver*. The Form also provides for a waiver when the buyer proceeds after due diligence with knowledge of a breach of a seller representation and warranty. But for this purpose, the Form tests knowledge as of a date (i.e., the DD Disclosure Deadline discussed in 3.3.7 above) that is slightly earlier than the expiration of the due diligence period (to give the buyer a minimum amount of time to react). The Form also takes an additional step to protect the buyer from getting sandbagged by a seller who fails (or plans not) to share accurate information at the outset: this due diligence waiver does not apply if the seller knew of the breach as of the effective date of the purchase agreement. But the buyer is not being sandbagged if the buyer knows of the breach when it signs the purchase agreement; and consequently, there is an additional waiver for breaches known to the buyer when the purchase agreement becomes effective.

8.4 **Materiality Threshold and Cap**. Purchase agreements commonly provide the seller with a materiality threshold and an aggregate cap on liability after closing.[217] The relevant amounts are to be established as deal terms in the Form. The relevant exceptions have previously been discussed.[218] Sometimes the materiality threshold is structured instead as a deductible, where the buyer does not collect the amount of the deductible even if it is exceeded.[219] While the *deductible* approach (in whole or in part) is common in corporate acquisitions (especially larger

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217 *See, e.g.*, STEIN, *supra*, § 2.49 ("[I]t is increasingly common for the parties to agree that there will be both a floor and a cap on the seller's liability after the closing.").

218 *See, e.g.*, Stevens A. Carey, *Pre-Negotiated PSA: Streamlining the Sale Process*, ACREL NEWS & NOTES (Apr. 2020).

219 *See, e.g.*, STEIN, *supra*, § 2.49 ("[One] floor functions like an insurance deductible and prevents the parties from getting into disputes over relatively trivial sums. Another type of floor is known as a 'dollar one' floor: once aggregate damages exceed the floor, the seller is liable for all of these damages from the first dollar.").

ones),[220] it is not common in the author's experience in real estate transactions and is not followed in the Form. Also, purchase agreements encountered by the author rarely provide materiality thresholds or caps to protect the buyer, presumably because the buyer has fewer obligations. In purchase agreements with reciprocal indemnities (for pre-closing and post-closing liabilities), one might question this rationale. But the Form does not contain such indemnities (as discussed in 8.6 below), and does not provide a materiality threshold or cap for the buyer.

8.5 **Damage Exclusions**. Sellers frequently provide that they are not liable for certain types of damages (e.g., consequential or punitive damages).[221] Often, such limitations are drafted to benefit both parties.[222] Consequential damages may not cover lost profits if the lost profits are *direct* damages (e.g., a lost profit component of benefit of the bargain damages)[223] but sometimes lost profits are excluded as well.[224] The Form contains an exclusion from recoverable damages for consequential damages and punitive damages only and there is an exception in the context of indemnification obligations when such otherwise excluded damages are claimed by a third party. This restriction benefits both parties *before and after* closing.

8.6 **Post-Closing Indemnity**. Sometimes purchase agreements require each party to indemnify the other party after closing for consequences of the indemnifying party's breach.[225] Such an indemnification may be replaced or supplemented by (x) an indemnity covering other matters before and after closing respectively,[226] or (y) an indemnity for breaches of leases and contracts assigned (rather than the purchase agreement).[227] An obligation to indemnify for

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220 *See, e.g.*, Eric Rauch & Brian Burke, *The Impact of Transaction Size on Highly Negotiated M&A Deal Points*, ABA, BUSINESS LAW SECTION, MERGERS & ACQUISITIONS (July 8, 2016) ("[F]or deals having a purchase price of less than $10 million, deals with no basket or first dollar baskets make up 72.7 percent of the deals, while deals with deductible baskets make up only 27.3 percent. . . . 47.8 percent of deals having a purchase price greater than $250 million contain deductible or combination baskets . . . . The data reflects that as deal size increases, sellers are generally able to negotiate better liability basket terms." (footnote omitted)).

221 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.07 [Office Building Purchase Agreement Form], § 5.4 at 115 ("In no event shall Seller be liable for any consequential or punitive damages . . . ."); SAFT, *supra*, § 9:28 [PSA for office building], § 5.4 at 9-151 ("Additionally, in no event shall Seller be liable for any consequential, speculative, remote or punitive damages.").

222 *See, e.g.*, WARREN'S FORMS, *supra*, § 20.2.01 [Raw Land Purchase Agreement Form], § 17.3 at 29 ("[I]n no event shall either party be liable to the other party for consequential, special, indirect or punitive damages."); STEIN, *supra*, App. B, § 1.1 at 369 (Definition of Damages).

223 *See, e.g.*, West Consequential Damages Article; West and Dugan, *supra*.

224 *See, e.g.*, SAFT, *supra*, § 9:26 [PSA], § 1.1 at 9-87 (Definition of Indemnified Loss).

225 *See, e.g.*, STEIN, *supra*, App. B, Art. 7 at 389–90; SENN, *supra*, § 5.04[B][4] at 5-19–5-22, EX. 5-3, § 15.1(ii) at 5-75 and § 15.2(ii) at 5-75 (although listed as optional); SAFT, *supra*, § 9:26 [PSA], §§ 15.2–15.7 at 9-102.32–9-102.35.

226 *See, e.g.*, SENN, *supra*, § 5.04[B][4] at 5-19–5-22, EX. 5-3, § 15.1(i) at 5-75 and § 15.2(i) at 5-75 (although listed as optional); SAFT, *supra*, § 9:12 at 9-47–9-48 (limited to representations, warranties and covenants that expressly survive termination or closing).

227 Indemnities limited to breaches of assigned leases and contracts (before and after closing) may be contained in the assignment and assumption of leases and contracts (rather than the purchase agreement). *See, e.g.*, MA. PSA FORM, *supra*, Exh. H (Assignment of Leases) and J (Assignment of Contracts); ARNOLD & KOVE, *supra*, § 28:21 [Assignment of Contracts . . .], § 3 at 28-15. A seller may limit such indemnities to *actual third party* claims (by the tenant or the counterparty to the assigned contract) to avoid expanding its liability for matters the seller refused to

breaches typically, in the author's experience, continues to apply following the closing.[228] And it may be an exclusive remedy after closing.[229] While the Form contains indemnification relating to due diligence investigations, letter of credit security deposits, broker claims, and tax free exchanges, there are no other indemnities, and in particular no indemnity for breaches. Aside from an obligation to defend third party claims, it is not clear what indemnification for a breach is intended to add to the contract damages that would already be payable as a result of such breach; and it may function as an invitation to litigators to come in the back door for consequential and other damages that may otherwise be excluded. Consequently, even though liability for a contract period breach survives the closing, the breaching party will not have an obligation to defend third party claims arising from the breach. But this position (i.e., the absence of other indemnities) seems relatively common in the author's current experience, is consistent with the goal of most sellers to minimize post-closing liabilities, and takes some pressure off the seller credit enhancement issue, which is not resolved in the Form.

9. SUMMARY OF FORM APPROACH

Ideally, the Form should represent positions that a party might be willing to accept if it knew it had to use the Form but didn't know whether it would be a seller or a buyer. To this end, members of our Committee have taken turns reviewing drafts on behalf of one party and then on behalf of the other party, with the understanding that they should not provide any comments that they would refuse to accept if they were on the other side of the transaction. As might be expected, there are differences of opinion yet to be resolved. We may use a survey to help resolve those differences. The drafting process is far from over and will not be complete until the Form is actually tested to refine the portions that may have been overlooked or not fully or properly considered. The Form is also intended to look familiar, or at least not too foreign, to the reader. One of the goals of this project is to gain acceptance of the Form, which requires not veering too far off the course of what real estate attorneys and other professionals are accustomed to seeing. With these thoughts in mind, here is a summary of some of the provisions in the Form intended to address remedies and closing conditions triggered by a breach, none of which is cast in stone:

9.1 **Remedies for a Party's Breach**. As noted at the outset (in 1 above), there has been some attempt to make more of the remedies for a party's breach available when that party owns the property to mitigate the credit issues present in most real estate purchase agreements. In light of the limits on the buyer's damages (and the fact that the pre-closing limit is generally lower than the post-closing limit), the Form's shifting to (or expansion during) the pre-closing period of buyer remedies may not appear as meaningful as the Form's shifting to (or expansion during) the

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cover in its representations and warranties (e.g., in an as-is sale, the seller may not want to indemnify for physical problems with the building that may constitute a breach of a lease but as to which the tenant is not complaining). In an effort to reduce lingering liabilities, the seller may prefer not to provide any such indemnity at all; and to that end, the seller may be willing to forego any such corresponding indemnity from the buyer. The Form does not contemplate any such indemnity.

[228] *See, e.g.*, STEIN, *supra*, App. B, § 7.4 at 390 (survives closing); SENN, *supra*, EX. 5-3, § 15.3 at 5-75 (survives closing); SAFT, *supra*, § 9:12(c) at 9-47–9-48. The indemnity may also survive *termination* of the purchase agreement. *See, e.g.*, SAFT, *supra*, § 9:26 [PSA], § 15.7 at 9-102.35 (survives termination and closing).

[229] *See, e.g.*, STEIN, *supra*, App. B, § 7.5 at 390; SAFT, *supra*, § 9:26 [PSA], § 15.6 at 9-102.35 (exclusivity is subject to several carve-outs).

post-closing period of seller remedies. But that disparity aligns with the fact that the Form does not provide for any credit enhancement or other similar protections to address the buyer credit issue, while it does provide for a number of alternatives to address the seller credit issue for the consideration of the parties.

9.1.1 Seller Remedies. The seller's right to cancel the purchase agreement and obtain the deposit as liquidated damages is available for only two breaches, namely when: (1) the buyer fails to make the additional deposit after notice and a cure period, or (2) the closing doesn't occur by reason of the buyer's material breach of its obligation to close. The seller also has the right to cancel, without the right to the deposit as liquidated damages, for a material breach of the buyer's representations and warranties as of the scheduled closing date. The Form does not prohibit the seller from bringing an action for damages for a pre-closing breach other than the two breaches that trigger liquidated damages. But the buyer's liability for damages caused by any buyer breach survives the closing and there are no anti-sandbag protections for the buyer, so the seller has recourse against the buyer when the buyer owns the property for breaches not covered by the deposit.

9.1.2 Buyer Remedies. The buyer's default cancellation right in the Form is much broader than the corresponding right of the seller: the buyer may cancel the purchase agreement on account of any material seller breach existing on the scheduled closing date. Although the buyer's recovery is generally limited to capped reimbursement, the seller is likely to own the property when the recovery is sought.[230] The buyer must choose to specifically enforce the agreement or cancel the purchase agreement if the seller is in material breach on the scheduled closing date and that is the sole remedy for any breach by the seller prior to closing (except, if the closing occurs, for the buyer's right to seek damages for liability that survives closing). If a specific performance action is not required to close the transaction, then the buyer may also simply proceed with closing without waiving its post-closing rights and remedies; but any post-closing rights and remedies are subject to the post-closing limitations (e.g., the anti-sandbag provisions, the threshold and the cap).

9.2 **Closing Conditions Based on a Breach**. To avoid inconsistencies with the default cancellation rights, the closing condition section of the Form does not include closing conditions based on a breach. There is a closing condition based on the other party's representations and warranties not being accurate on the scheduled closing date, which could involve a breach (but in the latter event, the remedy provisions control). For some practitioners, this approach may seem like a departure from custom, but it cuts both ways (affecting both the buyer and the seller in similar ways) and default cancellation rights are still addressed.

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[230] There are also circumstances involving a Fraudulent/Bad Faith Seller Breach for which the Form allows the buyer to seek unlimited direct damages, and it is possible that the seller does not own the property at such time. A logical argument can be made that the joinder guaranty alternative discussed in 1.1.2 above should also cover the buyer's damages if the seller no longer owns the property due to a Fraudulent/Bad Faith Seller Breach. However, such an expansion of the joinder guaranty alternative has been rejected to date because: (1) it may be atypical for many practitioners (who are more accustomed to seeing a seller guaranty, if any, cover only the seller's post-closing liabilities), (2) as noted in 3.3.7 above, the unlimited damage provision has not been uniformly accepted by our Committee, and (3) in the modern world of technology (in which information flows freely and quickly), the risk of a bona fide purchaser, which puts the property beyond the reach of the buyer, seems remote.

9.3 **Related Subjects**. Two related subjects that gave rise to several comments from our Committee members are (1) cure rights, and (2) survival.

9.3.1 Cure Rights. In the Form, the buyer has a right to cure before losing its initial deposit for failing to timely fund an additional deposit. There is also a built-in cure right before the buyer can exercise its default cancellation right due to a contract period seller breach because the buyer's right to cancel is available only if the seller is in material breach of the purchase agreement on the scheduled closing date. For buyer contract period breaches, the seller has no cancellation right unless the buyer materially breaches its obligation to close. The seller also has cure rights with respect to buyer' termination rights for title objections. But otherwise the Form does not include cure rights, recognizing that there may be circumstances in which parties they choose to add them.

9.3.2 Survival. The Form attempts to avoid the confusion associated with the concept of survival. It limits the use of the term *survival* to establish the period during which a cause of action for damages may be brought. If an obligation is intended to continue to apply (i.e., the parties intend that the obligor must continue to comply with the obligation) after termination or closing, then the Form uses the term *continue*. For clarity, the Form also defines Post-Closing Obligations and Post-Termination Obligations as well as Surviving (Closing) Liabilities and Surviving (Termination) Liabilities, but this approach may appear cumbersome. Perhaps a more streamlined approach will be found.

10. FINAL NOTE

If you have contrary thoughts about any of the matters discussed in this article (including the features of the Form described in this article or the legal analysis), or if you have suggestions for alternative approaches to the issues discussed in this article that are likely to be accepted by both a buyer and a seller, please send them to me at scarey@pircher.com. And if you are interested in seeing the current draft of the Form, all you need to do is join our subcommittee. We are still looking for volunteers for, among other matters, state riders and riders for alternative factual assumptions (e.g., different property types). If you want to volunteer, please contact my secretary Dina Steele at dsteele@pircher.com; and if you are not already a member of the Acquisitions Committee but would like to be, please contact Rob Garbrecht at Rob.Garbrecht@mcafeetaft.com, and Caitlin McGrew at cdmcgrew@acrel.org.

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