

## NOTICE OF DEFAULT: REMEDIES FOR PURCHASE AND SALE AGREEMENT BREACHES

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What happens when a commercial contract buyer fails to purchase the property as required by the purchase and sale agreement (PSA) or otherwise commits a material breach?

### **Seller Remedies for Buyer's Breach.**

Here are specific remedy provisions to consider in the PSA, other than all "rights and remedies available at law or in equity":

- 1. Liquidated Damages.** The typical seller remedy for a buyer breach is retention of the deposit monies posted at the time of signing the PSA. This is another reason for both seller and buyer to carefully consider the amount of the deposit when finalizing the agreement of sale, as this is not just an expression of buyer's financial capability, but also the amount the buyer may forfeit to seller if it fails to close, after any contingency periods have expired. In NJ, liquidated damages provisions or stipulated damages provisions will be enforced so long as they are a reasonable estimate of the actual damages and not an impermissible penalty. Where the agreed upon amount is unconscionable, a court may refuse to enforce this remedy.
- 2. Specific Performance.** An atypical remedy for a buyer breach in favor of a seller is a court ordering that the purchaser buy the subject property. It is rare that a court will find that money damages are an inadequate remedy or that there are other equitable considerations, and therefore, the buyer must purchase the property.
- 3. Preserve Indemnity Obligations.** While the liquidated damages provision is likely the exclusive remedy, a seller may also carve-out the buyer's continuing obligation to indemnify seller for any damage caused by buyer or its representative in connection with buyer's examination of the property. Given that the buyer entity may be a newly formed (and empty) special purpose entity (SPE), seller should confirm that buyer and its representatives have insurance in place to protect seller for personal and property damage. And, if the agreement of sale is assigned to a new SPE, seller should ensure that the original purchaser remains liable under the PSA.
- 4. Delivery of Due Diligence Materials.** If buyer breaches the PSA resulting in termination, seller may demand delivery of buyer's due diligence materials, including items like its title commitment, survey, environmental, property condition and zoning reports and any approvals, at no cost to seller. Buyer will want to be reimbursed the actual cost for these materials. A distinction should be drawn between delivery of the materials following a buyer breach versus following a termination under the due diligence contingency. An argument may be made that following a breach, seller should not have to reimburse the buyer for these costs.

A quick note about time being of the essence. While most South Jersey contracts contain a provision making time "of the essence" thereby setting a specific time frame for establishing a breach, many North Jersey

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PSAs do not. Where time is not made “of the essence” in the agreement of sale, a party can declare it to be so by delivering a written notice to the defaulting party after the date set for closing has passed. Following the failure to close, a written notice may be delivered demanding a new closing date, provided that it is reasonable in relation to the time that has passed. It should be no shorter than 10 days following the notice. The party ready, willing and able to close, will send this notice to the other to clarify whether there is a breach situation. Additionally, a party may declare time to be of the essence prior to the closing date where the other party has anticipatorily repudiated or breached the PSA.

Notices and opportunities to cure may be included in the agreement of sale prior to a particular remedy being available.

### Buyer Remedies for Seller’s Breach.

Sellers are guilty of breaching PSAs too. There are two general categories of seller breaches: failure to close and breach of representations. For failure to close, the two most customary remedies are:

**1. Termination, Return of Deposit and Compensation.** If the seller does not complete closing, which sometimes happens when it is unable to deliver good title or when it changes its mind -- perhaps due to a better offer -- buyer is entitled to terminate the PSA and receive a refund of its deposit. Where this right is buyer’s only remedy, and savvy sellers are effective at making it so, the seller essentially has an option contract. If seller elects to breach (eg. to sell the property for a higher price or to take the property off the market), buyer may be limited to a termination right and the return of its deposit. In that scenario, buyer is stuck footing the bill for all of its diligence costs, attorneys’ fees and lender costs and expense. Therefore, buyers should seek to be reimbursed for these actual, out of pocket expenses (sometimes capped at a reasonable amount), in addition to the return of the deposit.

**2. Specific Performance.** If seller fails to close, buyer may be entitled to enforce specific performance against seller, provided that buyer has complied with its PSA obligations and commences the action within a reasonable period of time following the breach, say 45 days. Unlike the seller remedy which is extremely rare, a court is more willing to agree that the property is unique, and therefore buyer cannot be adequately compensated for seller’s breach with money alone. It is easier to convince a court to force the sale of the property to a buyer with “clean hands”, so buyer should make sure it has complied with its PSA obligations. In anticipation of filing an action for specific performance, and perhaps as leverage in negotiating a settlement, the buyer may file a notice of lis pendens with the county recorder’s office indicating that it has a claim against title to the subject property. Doing so places the world on notice of the claim and essentially prevents sale of the property to another buyer or seller financing of the property. Some sellers will seek to prevent such filings by adding language which prohibits the filing of a lis pendens in the PSA. If specific performance is not available after being elected as a remedy, the PSA may state the buyer is able to recover all of its damages, without limitation.

For breach of a seller representation discovered post-closing the remedies may be based on parameters set for recovery in the PSA. The PSA may include language regarding: (i) a basket or deductible amount by which the damage must exceed for the claim to be actionable; (ii) a cap or maximum seller-liability amount; and (iii) a post-closing survival period for the representations and a period of time within which any claims must be made, which periods may be the same. Sellers will look to insert a high basket amount, a low cap on liability

and a very short survival period. The dollar amounts will vary depending on the size of the transaction and the negotiating leverage of the parties. The survival period may vary significantly from PSA to PSA and may also vary within the PSA depending on the specific representation and its importance to the transaction. If the breach is discovered pre-closing and closing occurs, typically, no post-closing remedy will be available. Both buyer and seller should appreciate a prevailing party attorneys' fees provision, like: "In the event either party employs an attorney in connection with claims by one party against the other arising from the operation of this PSA, the non-prevailing party shall pay the prevailing party all reasonable fees and expenses, including attorneys' fees, incurred in connection with this transaction and the collection of any judgment." This can significantly increase costs for a breach.

### Conclusion

At the time of PSA negotiation, the parties rarely believe that either side will actually breach their agreement. Nevertheless, sufficient time should be spent considering the "what ifs" should the transaction go south. The parties will want to be clear on the respective remedies so that they can move on quickly following a breach. Since the deposit going to seller will often be the remedy for a buyer's failure to close, care should be given in determining the amount. If the deposit is disproportionately high compared to the monetary damages the seller will actually suffer in the event of a buyer breach, perhaps only a portion should be delivered to the seller with the balance being returned to buyer. Conversely, if the deposit is too low relative to seller's anticipated damages, perhaps the seller should receive additional compensation. Remedy provisions should not be considered boilerplate. The parties to a PSA should consult with experienced counsel to understand the rights and remedies, and their many variations, following a breach.

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