Beyond Specific Performance: Recovering Your Damages Through Escrow, Following A Specific Performance Judgment

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The Opportunity

• Most developers have been there a few times.

• You found a great property, and it’s perfect for your newest development.

• You’re in escrow, and closing is imminent.

• But ...
The Problem

• The seller refuses to close, without justification.

• The seller possibly wants to renegotiate the deal.

• You have explained the consequences of refusing to close the deal.

• The seller is not responding to reason.

• What do you do now?
The Common Options

• Too often, especially where the purchase price does not exceed $1,000,000, a developer’s instinct, ratified by their broker’s or attorney’s advice, is to either:

1) Accept the extortion of a raised purchase price as the “cost of doing business”; or

2) Let the deal go, get back your deposit, and move on to another property; rather than spending time and legal fees forcing the sale, commonly known as a Specific Performance lawsuit.
The “Third” Option: Beyond Specific Performance

- A Specific Performance lawsuit, with a demand that all damages - including attorneys’ fees and costs, encumbrances and lost future rents or profits due to delays in closing - be paid directly as escrow credits following a court ordered closing.
Specific Performance

• “Specific Performance” is available where:

1) The buyer has put the seller on notice of its demand that escrow close;

2) The buyer has “substantially” performed its end of the bargain (e.g., paid its earnest deposit and cleared its contingencies, etc.);

3) The seller has not performed (e.g., refuses to close escrow);

4) The purchase and sale agreement (“PSA”) terms are sufficiently definite (which is generally the case in any legitimate real property transaction);
Specific Performance

• “Specific Performance” is available where: (cont’d)

5) The PSA is reasonable and fairly priced (e.g., the seller is not being unfairly taken advantage of);

6) The terms of the requested “forced sale” are “substantially similar” to the terms of the PSA; and

7) The buyer’s “legal remedy” (i.e., simply getting a money judgment against the breaching seller) is inadequate.

Specific Performance

1. Notice To The Seller

• It is generally a good idea to send an initial “demand” letter to the seller, laying out the dispute. But, if the situation requires a very aggressive approach, a complaint filed by the buyer is a sufficient tender for specific performance of an agreement to purchase real estate.

(Civil Code § 1440; Landis v. Blomquist (1967) 257 Cal. App. 2d 533, 537.)
Specific Performance

2. “Substantial Performance” by the Buyer

Specific Performance is available if the Buyer:
1) Has already “substantially performed” its duties under the contract;

2) Such performance is “assured”; or

3) Performance can be secured to the “satisfaction of the court”.

(Civil Code § 3386; Bleecher v. Conte (1981) 29 Cal 3d 345.)

NOTE: absolute and full performance of all PSA terms is not a pre-requisite for recovery.
3. Sellers Failure to Perform

- Where a seller holds equitable title to a property and has the power to acquire legal title, specific performance is available.

4. Sufficiently Definite PSA Terms

- The essential terms of the contract must be complete and certain and each material term must be expressed in a reasonably definite manner.*

*Generally, parties use standard relator forms which reasonably and accurately describe the property and the terms of purchase. As such, this element is rarely an issue for a specific performance plaintiff.

5. The PSA is Just and Reasonable with Adequate Consideration

- Adequacy is determined at the time the contract was made.

  \( \text{Petersen v. Hartell (1985) 40 Cal. 3d 102, 110.} \)

- Property value may be shown by the opinion of witnesses qualified to express such opinions, including through an expert or a “person entitled to possession of the property” (and if a corporation, the officers and employees knowledgeable of the value of the property).

  \( \text{Evidence Code section 813(a) and (c).} \)
Specific Performance

6. The Requested Performances is Substantially Similar to the Contract Terms

- The performance required need not be identical with that promised in the contract.

- Performance may be so drawn as best to effectuate the purchases for which the contract was made.

- Performance may be granted on such terms and conditions as justice requires.

(Rogers v. Davis (1994) 28 Cal. App. 4th 1215.)
Specific Performance

7. Any Legal Remedy is Inadequate

“It is to be presumed that the breach of an agreement to transfer real property cannot be adequately relieved by pecuniary compensation.” For single-family dwellings which the party intends to occupy, this presumption is conclusive. “In all other cases, this presumption is a presumption affecting the burden of proof.”

Specific Performance

7. Any Legal Remedy is Inadequate (cont’d)

- Generally, a strong argument can be made that the buyer is entitled to the presumption that its legal remedy is inadequate.

- Focus on evidence establishing that the buyer specializes in acquiring the type of property at issue in the suit, and improving them for a specific purpose in the marketplace.

- The buyer should also make efforts to explain to the court that few properties of the type in question become available for sale, and that even fewer properties specifically fit the buyer’s business model.

- As such, an award of damages would not be adequate to make the buyer whole in light of the unique opportunities afforded by the property in question.
The Payoff: Damages Paid Through Escrow “Credits”

• Seek damages, including prospective lost profits, to be deducted directly from the purchase price in escrow.

• Having damages “directly paid” removes the single most difficult step in the litigation process; collection.
1. Deducting Damages Due to Liens, Taxes and Other Encumbrances

- If liens, claims or other defects in title exist, a seller may be required to convey what interest he or she has in the property and the buyer may receive compensation for the deficiency in performance.

1. Deducting Damages Due to Liens, Taxes and Other Encumbrances (cont’d)

• Moreover, most standard PSAs clearly require that taxes be “paid current” and prorated between buyer and seller.

Thus, in addition to an order of specific performance,

• Buyers should ask the court to direct that common debts such as property taxes and judgment liens be deducted from the purchase price and/or paid and satisfied through escrow before title passes to the buyer.
2. Deducting Lost Rent or Profit Damages Due to Delayed Performance

• A buyer seeking specific performance has generally lost possession and use of the property during the delay in receiving title.

• As such, the buyer is entitled to **offset** from the purchase price any lost rents or profits and increased costs caused by the delay.
2. Deducting Lost Rent or Profit Damages Due to Delayed Performance (cont’d)

*Bravo v. Buelow* (1985) 168 Cal. App. 3d 208, 213-215 (buyer credited $70,000 for increased construction costs of $20/SF resulting from delay);

*Hennefer v. Butcher* (1986) 182 Cal. App. 3d 492, 505 (increased development costs $150,000 offset from $1.05 million purchase price);

2. Deducting Lost Rent or Profit Damages Due to Delayed Performance (cont’d)

• Such offset or credit is *not* a breach of contract damage, but designed to relate specific performance back to the date escrow was supposed to close and adjust the equities between the parties due to delayed performance. (*Id.*)

• To obtain such credit and offset, no specific pleading is required.

(*Greenstone*, 173 Cal.App.2d at 34-35 (though complaint did not allege or pray for offset of lost rents, trial properly credited plaintiff $34,011.20 in lost apartment rentals against the purchase price).)

• As such, buyers should always seek such escrow credits in this type of specific performance action.
3. Attorneys’ Fees

• Buyers should make sure to seek all attorneys’ fees and costs associated with the specific performance action.

• Such fees and costs are of course not generally available under statute, but are almost always specifically provided for in the PSA.
Michael R. Newhouse Biography

Michael R. Newhouse is a Shareholder in the Firm’s Litigation Practice Group in Los Angeles. Mike’s broad-based practice includes counseling and representing large businesses, small businesses, and individuals. Clients include members of the apparel industry, technology companies, insurers, licensors, financial institutions, accredited investors, multi-media and post production companies, interior designers, and jewelry industry clients. Additionally, a significant part of Mike’s practice is real estate related, and focuses on representing developers, landlords, tenants, property managers and financial institutions in all aspects of commercial and residential real estate litigation and transactions. Recent transactions and litigation involve shopping centers, office and industrial buildings, residential subdivisions, residential and commercial condominiums, hotels, and golf courses.

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