

## **BE CAREFUL WHEN MAKING A BACK-UP® OFFER**

By Dale Alberstone, Esq.

Real estate purchase agreements often contain a provision that the seller may continue to receive back-up® offers even though the seller has an accepted contract with the buyer. Under real estate law, it is perfectly legal for the seller to include such a provision in the purchase agreement and perfectly legal for the seller to thereafter receive back-up offers from other prospective purchasers.

What is not legal, however, is for the seller to cancel the purchase agreement in order to accept a higher offer from a new prospective purchaser, even if the offer is substantially higher. Not only would that constitute an ordinary breach of contract by the seller, it would also constitute a breach of the seller's implied covenant of good faith and fair dealing.

The law implies in every contract the covenant of good faith and fair dealing. Broadly stated, that covenant requires that neither party do anything which would deprive the other of the benefit of the agreement. (Ocean Services vs. Ventura Port, 15 C.A.4th 1762)

Let me give you an example of the application of the covenant of good faith and fair dealing. Suppose that a seller, who is under a \$2,000,000 contract and existing seller, desires to cancel the transaction so that he may accept a new buyer's back-up offer of \$2,500,000. Also suppose that the lender requires, as most lenders do, that its appraiser inspect the interior common areas of a security building as a condition to loan approval. Also suppose that without that interior inspection, the lender will not make the loan. The seller would be in breach of the implied covenant if he failed to allow the appraiser access to the common areas, with the anticipation that the lender will not make the loan and, therefore, the buyer will not be able to consummate the transaction. Since the motive behind the seller's lack of cooperation was to re-sell the property to the prospective purchaser making the back-up offer, the seller, when refusing common area access, would be liable to the first buyer for damages for breach of the implied covenant of good faith and fair dealing.

Similar laws apply to prospective purchasers who submit back-up offers. It is perfectly legal for a prospective purchaser to make a back-up offer to the seller even though the prospective purchaser may know of the existence of the seller's contract with the buyer. However, in submitting such an offer, the prospective purchaser needs to be cautious, lest he be liable to the initial buyer for inducing the seller to breach the contract. That would be particularly true if the prospective purchaser submitted the back-up offer with the intent to induce the seller not to sell the property to the buyer, but to instead sell it to the prospective purchaser.

There are three different types of legal theories under which the prospective purchaser may be liable to the buyer:

- 1. Inducing A Breach of Contract:** If the prospective purchaser has knowledge of the contract and intends to induce its breach by submitting the back-up offer, the prospective purchaser may be liable to the buyer for any damages that the buyer suffers because of the seller's breach. Although there is no judicial opinion exactly on point, I anticipate that the court will also require some proof that the prospective purchaser had some expectation that his submission of the back-up offer would in fact induce the seller to breach the contract.
- 2. Interference With the Contractual Relationship:** This second theory is slightly broader in that it protects against intentional acts not necessarily resulting in a breach of the contract. If the prospective purchaser commits intentional and unjustified acts designed to interfere with or disrupt the buyer's contract with the seller, the prospective purchaser may be liable to the buyer for damages which the buyer suffers as a result of actual interference with or disruption of the relationship.
- 3. Interference With Prospective Economic Advantage:** This third theory is still broader in that it protects against intentional acts designed to harm an economic relationship which is likely to produce an economic benefit to the buyer. It requires that the buyer have an economic relationship with the seller concerning the probability of a future economic benefit, the prospective purchaser had knowledge of that relationship, the prospective purchaser committed an intentional and unjustified act designed to disrupt the relationship and the relationship was actually disrupted, causing the buyer damages. This type of liability generally arises where the buyer does not yet have a contract but in fact has an economic relationship with the seller which would give rise to the probability of a future economic advantage.

The first two theories of liability are rather straightforward and relatively easy to understand. The third

theory, however, is much more nebulous. Generally it applies to parties having an on-going business relationship. It would rarely apply to a seller who is negotiating with a buyer with whom he has never before been involved. For example, it is unlawful for a prospective purchaser to submit his own higher offer to a seller even though he knows that the first proposed buyer has submitted an offer which the seller has not yet accepted. In that circumstance, of course, the prospective purchaser's offer would not be a back-up offer because there was no already existing contract.

A real estate licensee who submits a back-up offer on behalf of a prospective buyer or presents a back-up offer to the seller should also be careful that he/she does not receive or present the offer with the intent to cause the seller to breach the contract or with the intent to disrupt the contractual relationship between the seller and buyer. The real estate licensee may have similar exposure for damages to the buyer under the three theories discussed above.

In summary, back-up offers are generally lawful and play a significant role in the sale of real estate. Prospective purchasers, sellers and real estate agents need to be particularly circumspect about presenting or receiving back-up offers once a contract has been entered into between the buyer and the seller. If the back-up offer interferes with the sale of the property to the buyer, the buyer may pursue causes of action (i.e. litigation) against the prospective purchaser or licensee for inducing breach of contract and interference with contractual relations. The buyer may also have causes of action against the seller for breach of the implied covenant of good faith and fair dealing as well as ordinary breach of the contract.

#### NOTE TO ATTORNEYS

Attorneys who wish to further brief themselves on the three different theories of liability should review Shamblin vs. Berge, 166 C.A.3d 118. That case presents an excellent discussion of the differing elements and nuances among the three theories.