

\$2,000 OVER BEST OFFER

In a time of shrinking inventories of desirable homes, many buyers have become desperate in their efforts to purchase a new home. It would appear that buyers across the state are resorting to a form of offer which they hope will prevent them from being outbid on the home of their dreams. These buyers are inserting a provision in their offers which they believe will maximize their chance of success.

A hypothetical is the easiest vehicle to explain this technique. Buyer A makes an offer on 123 Elm Street for \$150,000. The offer goes on to provide that Buyer A will increase his offer to \$2,000 more than any competing offer made for 123 Elm Street (the “Open-Ended Offer”). On a number of occasions we have been asked whether this technique poses any specific risks to Buyer A and if so, can a clause be constructed that will completely remove those risks. The answers to the questions appear to be “yes” this technique does pose risks, many of which may be addressed in some fashion, but which would result in one of the most complex clauses ever appearing in a residential real estate purchase agreement.

First, the use of the Open-Ended Offer on its face subjects Buyer A to limitless financial exposure. If Buyer A offers \$150,000 for 123 Elm Street, a competing offer could be received for \$300,000, making Buyer A contractually liable to pay \$302,000. This danger can effectively be limited by putting a cap on how high Buyer A will go in topping competing offers. For example, Buyer A could supplement the Open-Ended Offer by indicating he will pay not more than \$160,000.

Second, Buyer A could find himself paying \$2,000 more than a fake “competing offer” of \$158,000 submitted by the Seller’s cousin or golf buddy solely in order to inflate the purchase

price. Buyer A could try to protect himself against such a scheme by inserting into the Open-Ended Offer the words “bona fide” or “good faith” with respect to any competing offer, *i.e.*, he will pay \$2,000 over any bona fide, good faith competing offer. While those words have legal meanings which can be applied by a court, the “good faith” or “bona fide” offer turns on specific facts of each case, and a great deal of money could be spent litigating whether Buyer A is stuck paying \$160,000, or if the Seller’s cousin’s offer is not “bona fide” or in “good faith.” An attempt could be made to try and insert in the contract a definition of “bona fide” or “good faith,” but the Open-Ended Offer would simply be made longer without injecting any additional certainty as to what constitutes a legitimate offer.

Third, Buyer A could try to protect himself against fake offers by indicating that he will only pay \$2,000 more than any competing offer if a copy of the competing offer is provided to him and is supported by a bank pre-qualification or pre-approval letter indicating the second buyer is qualified to purchase 123 Elm Street at the price offered by that buyer. Unfortunately, there is no standard criteria by which a lender will issue a pre-qualification or pre-approval letter. Some lenders actually undertake a credit check prior to issuing such a letter, while others more freely issue these letters with conditions, *e.g.*, the second buyer being creditworthy to borrow the funds. Again, terms could be inserted in the Open-Ended Offer to define what would be considered a pre-qualification or pre-approval letter, *e.g.*, a commitment to finance without conditions, but, again, the Open-Ended Offer simply gets longer and a pre-qualification or pre-approval letter without conditions may simply not exist in this market.

Fourth, a buyer can try and protect himself from the risks of what is perceived to be an excessively high competing offer by inserting a number of other terms in the Open-Ended Offer. For example, a contingency could be inserted in the Open-Ended Offer indicating that the Open-

Ended Offer is subject to an appraisal at or above the purchase price by an appraiser selected by Buyer A. For example, Buyer A could elect to terminate the agreement if the property did not appraise at \$160,000. Alternatively, Buyer A could make certain that an extremely broad inspection clause was inserted in the Open-Ended Offer. While Buyer A should certainly proceed in good faith in regard to any inspection report, he may well become more demanding if he believes the competing offer is excessive or not made in good faith. Further, if Buyer A's Open-Ended Offer is contingent on financing; he may well be protected if the property will not appraise to support the higher purchase price.

Sixth, Buyer A must also determine how long he wishes to be at risk through the Open-Ended Offer. He can address this risk by putting an end date on the Open-Ended Offer, *e.g.*, he will pay \$2,000 over any competing offer for a period of five days from the date of his offer.

Seventh, perhaps one of the greatest challenges with the Open-Ended Offer is making certain that the Open-Ended Offer and the competing offer are compared as apples to apples. Assume that Buyer A's Open-Ended Offer is for \$150,000 cash. The competing offer is for \$158,000, but with \$10,000 of Seller's concessions. Is Buyer A bound to pay \$160,000 or would the competing offer be treated as having a "net" value of \$148,000? There is no Michigan case law on this issue; thus, it would be up to the REALTOR® for Buyer A to define in the Open-Ended Offer how the amount of any competing offer will be determined, *e.g.*, net of Seller's concessions as well as amounts which are offered for Seller's personal property and the like.

Finally, perhaps the ultimate challenge with using an Open-Ended Offer could occur if the competing buyer also submitted an offer saying she would pay \$3,000 more than a competing offer. Upon submission of Buyer A's Open-Ended Offer of \$150,000, the competing buyer's offer would move to \$153,000. Arguably, Buyer A's Open-Ended Offer would then move to

\$155,000 and the process would continue until a cap was reached in one of the two Open-Ended Offers. And who knows what the result would be or should be if there is no cap on either Open-Ended Offer.

As can be seen, even with great care in drafting the terms of an Open-Ended Offer, it is not possible to eliminate all potential, risks. In the end, a court may decide that an Open-Ended Offer is too vague to be enforceable. The risk of a lengthy and expensive litigation must be taken into consideration when using an Open-Ended Offer.

Merger Clauses: How Much Protection Do They Provide?

The Michigan Court of Appeals recently reviewed the effect of the following clause in a purchase agreement from the sale of real property in Michigan:

It is further understood that no representations or promises have been made to Buyer by real estate brokers or sales persons or by the Seller other than those contained in this agreement or as otherwise made or given by the Seller to the Buyer in the written disclosure statement.

(the “Integration Clause”).

In this case, the Buyers were seeking to purchase real property located next to a lake. The Buyers claimed that while viewing the property, a representation was made to them that the property included 50 feet of lake frontage. A document titled “Agent Detail Report” stated that the property is lakefront with 50 feet of frontage. It also should be noted that this report contained a disclaimer that the “information contained herein should be deemed reliable but not guaranteed, all representations are approximate and individual verification is recommended.” The Buyers were allegedly told that there were two undeveloped roads bordering the lake side of the property and that the two roads ended where they intersected, resulting in about 20 feet of the

beach as public property and over 50 feet of the beach as their private beach if they bought the property. The Buyers bought the property.

According to the Buyers, about a year later, they were informed by their neighbor (as always seems to be the case) that they did not have any lake frontage. Further, the neighbor advised them that the Seller knew there was no lake frontage because of prior litigation between the neighbor and the Seller. The Buyers checked with the Cass County Road Commission who informed them that one of the roads did not end, but instead ran the entire length of the beach. Upon contact from the Buyers, the township assessor confirmed that the property was incorrectly classified as lakefront. The assessor then substantially reduced the assessment on the property from \$227,000 to \$125,700.

The Buyers sued the Seller and the Seller's REALTOR® for misrepresenting that the property had lake frontage. The Seller was granted summary disposition on the Buyers' claims by the trial court. The trial court found that based on the Integration Clause in the purchase agreement, the Buyers could never prove fraud because they could not demonstrate that they reasonably relied upon the representations of the Seller. In other words, by signing the contract that contained the Integration Clause, the Buyers specifically disclaimed any reliance on the Seller's representations.

The Court of Appeals reversed the decision of the trial court and remanded the case back to the trial court for further proceedings based on the Buyers' misrepresentation claims against the Seller. The Court of Appeals went to great lengths to differentiate this case from prior Court of Appeals' opinions which would appear to stand for the proposition that a merger and integration clause generally defeats claims of misrepresentations made outside of the purchase agreement. The Court of Appeals determined that in the present case, the Integration Clause was

not effective to defeat a misrepresentation claim, if the misrepresentations were used to induce the Buyers to enter into the purchase agreement in the first place. In other words, a seller cannot use an integration clause in a purchase agreement to defend himself, if in fact the buyer can establish that he relied on those representations in entering into the purchase agreement.

This recent Court of Appeals opinion is unpublished, meaning it is not binding on other courts. Nonetheless, it can be cited to other courts. Thus, sellers and their agents should be aware that the use of a merger and integration clause may be of little help in defending against claims of misrepresentations allegedly made prior to entering into a purchase agreement, albeit that is one of the reasons for using such clauses.