**ESCALATION CLAUSES-BUYER AND SELLER BEWARE**

**BY: WILLIAM G. MORRIS, ESQ.**

Calling the local real estate market red-hot is like calling a bonfire a campfire. Properties can sell within hours of going on the market. Some properties sell for more than the listed price. Multiple offers are common. What’s a buyer to do? Not wanting to be outbid, some buyers want to use an escalation clause. How does that work, you ask?

An escalation clause is a provision in an offer which states the offer will increase above the starting price if the seller gets another offer higher than the starting price in the first offer. Escalation clauses often contain other terms. The amount to be added above the competing offer is usually one term. Many include a cap, above which the original offer will not escalate

That may seem simple enough. A buyer can offer $100,000 with a clause that says if the seller gets an offer higher than $100,000 the buyer agrees to pay $500 more than the competing offer, but not to exceed $120,000. The buyer thinks that will allow a lower offer than the buyer’s top dollar but keep the buyer in the game if another offer comes in. How does that look to the seller?

To the seller, an escalation can look like a game. The buyer is not willing to make a top dollar offer even though it is a hot market. The buyer is trying to get the property cheaper. That may not look like a buyer the seller wants to work with. The seller might think, “the buyer is a sharp operator and that worries me.”

The seller may have a hard time comparing offers. Closing costs, mandatory repair clauses, a contract clause allowing a buyer to terminate the contract and other provisions may not be identical in competing offers. For that reason, some using escalation clauses provide that the offer will increase to net the seller more than a competing offer. That means the seller has to calculate “net.” More than a few sellers will be uncomfortable making that calculation. It may be impossible to calculate, as when repairs can be required.

A seller considering accepting an escalation clause offer has more to worry about. Will the buyer agree the competing offer was bona fide? If not, the escalation clause buyer may sue the seller and tie the property up for months or years while the litigation proceeds. The seller pays thousands of dollars in attorney fees and might ultimately win. If the buyer refuses to close, most contracts limit the seller’s damages to the deposit. If the seller tries to collect attorney fees from the buyer, the seller might find the buyer is uncollectible. Even if the seller collects attorney fees, the property has been off the market for months, the market may have cooled in the interim and getting the deposit is nowhere near the seller’s actual loss.

Some sellers focus on the escalation clause to the exclusion of other aspects of competing offers. There may be a stronger offer on the table, albeit for a little less money. In an effort to get a contract at the highest price, the seller may come to regret passing on a stronger offer from a more qualified buyer. That can be a problem for both parties.

A lot of sellers will not accept an escalation clause offer and many attorneys counsel their clients to refuse them as well. They may seem like a good idea to a buyer in a hot market, but escalation clauses also bring problems for buyers.

One potential problem is being “gamed” by an unscrupulous seller who provides a fake offer as the competing offer. How will the buyer know if the offer the buyer outbid is really an offer? The buyer already told the seller the buyer’s maximum price via the cap in the escalation clause, so an unscrupulous seller might be tempted to create an offer just below that cap.

Including a cap in an escalation clause tells the seller the buyer’s top price. That does not leave any room for negotiation. It may allow the seller to simply counter at that top price. In any event, the buyer may be paying more than the seller would otherwise accept through a fixed price offer. An escalation clause may also tell the seller the buyer is committed to purchase and is not willing to walk away. That may hamper future negotiation if the escalation clause offer is not accepted but the parties continue to talk.

Escalation clauses can help create a contract. Escalation clauses can also create problems and in some cases interfere with creation of a contract. Before using an escalation clause, a buyer (and a seller) should consider all aspects of the situation and make sure he or she understands pros and cons of the clause. Because escalation clauses are more complex than they appear at first blush, this could be one time where consultation with an experienced real estate attorney is priceless.

Escalation clauses are not necessarily the best course in a hot market. If used, they should be used with caution.

***William G. Morris is the principal of William G. Morris, P.A. William G. Morris and his firm have represented clients in Collier County for over 30 years. His practice includes litigation and divorce, business law, estate planning, associations and real estate. The information in this column is general in nature and not intended as legal advice.***