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Watch Out For Exclusivity Clauses In Term Sheets For Real Estate Transactions



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I write about commercial real estate negotiations, deals and legal issues.



If you're not careful, exclusivity clauses can blow up in your face (even with nonbinding term sheets). [-] RANJAN SAMARAKONE

Early in any substantial real estate transaction, the parties will typically create a term sheet (or letter of intent) to describe the basic business terms of their possible transaction. They'll put down on paper what they think they want to do. But nearly every term sheet says no one will be bound unless they finally agree on and sign final documents.

Depending on circumstances, though, the parties will sometimes agree in a term sheet that they will negotiate exclusively with each other at least for a certain period. And they'll usually agree that the exclusivity restriction is legally binding.

What happens if someone violates that restriction? It doesn't happen much. One can't easily measure the economic injury that results from such a violation. A recent New York court decision suggested, though, that if a party violates an exclusivity restriction, they may in fact incur significant liability – whether or not they would have ultimately entered into a final transaction at all.

The recent case involved negotiations between the Durst organization (a major NYC property owner) and Amazon AMZN -1% for possible office space on Sixth Avenue in Manhattan. Durst and Amazon put together a term sheet with the basic business terms, plus an exclusivity clause that the parties agreed would be binding. Negotiations proceeded.

Somewhere along the way Amazon apparently became interested in a different building and started negotiations there at the same time.

While Durst and Amazon continued to negotiate their Sixth Avenue lease, Durst started some construction work to accommodate Amazon's needs, even though the parties hadn't yet signed a lease. And of course Durst also incurred substantial legal fees to negotiate multiple drafts of the lease.

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At a certain point in the negotiations, though, Amazon finally told Durst that Amazon had lost interest in the Durst building and would instead sign a lease at the second building.

Amazon argued that the second building wasn't competitive with the first, because Amazon would use it as a warehouse, not an office building. Amazon also argued that the negotiators for that other building came from a different Amazon division than the people who had negotiated with Durst. The court didn't buy any of those arguments, concluding that Amazon had "unquestionably breached" the letter of intent. Amazon's negotiations with the other property owner amounted to a "blatant violation" of the exclusivity clause.

Even so, Amazon still had no obligation to enter into a lease. So Amazon's liability for its breach of the exclusivity clause in the term sheet couldn't reflect the value of the unsigned lease itself.

Instead, the court seemed willing to let Durst recover from Amazon the costs Durst had incurred in the lease negotiations, on the basis that Amazon's inaccurate assurances of exclusivity had induced Durst to incur those costs, at least beyond a certain point in the aborted negotiations. The court also said Durst could recover from Amazon some or all of the cost of the construction work Durst had undertaken for Amazon. The court left the calculations for later.

Based on the rulings to date, it's clear the court thinks Durst should have a substantial claim against Amazon for violating the exclusivity clause, even though it may be difficult to calculate the exact amount of Amazon's liability.

The moral of the story, of course, is that parties to term sheets or letters of intent should take exclusivity clauses seriously, or not agree to them at all. A violation of such a clause won't create liability for the underlying transaction itself. It may nevertheless create substantial exposure. And the courts are willing to try to quantify that liability and make the violator pay.

The case is DOLP 1133 Properties II LLC v Amazon Corporate LLC, New York State Supreme Court, County of New York, Index No. 653789/2014. (Yes, the litigation started in 2014.)



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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**

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