Legal Brief

Seller Beware: The Death of the Nonrefundable Deposit

Not so very long ago, agreements for the sale of commercial and industrial real estate were riddled with contingencies for everything from financing and building condition, to environmental testing and wetlands inspections – and nearly all of them were for the benefit of the purchaser. In an era of full disclosure and plentiful supply of commercial properties, it was virtually impossible for a seller to deny the purchaser the right to inspect, analyze, prod or kick anything that the purchaser desired.

With each agreement, it seemed that a new and fuzzier contingency was born. Objective measurements of the satisfaction of contingencies gave way to the "reasonable satisfaction of the purchaser."

While such contingencies were often heavily negotiated, in the end they were usually so plentiful and expansive that they virtually converted the sale agreement into an option – the seller was bound but the purchaser was not – though an option with one major difference: Not only could the reluctant purchaser almost always find a reason to get out of the deal, he or she also could get back the deposit money.

If your memory is long enough, you will recall that historically option payments were nonrefundable – it was the price you paid for having the seller remove the property from the market before the purchaser was obligated to purchase.

And so it remained, if a purchaser was naïve enough to seek a true option, they were unable to collect their deposit. But if, instead, the purchaser proposed a sale agreement with 20 or so contingencies, voila, a functional option arose without having to risk your deposit! It was the best of both worlds – at least if you were a purchaser.

Rise of the Due Diligence Contingency

Rather than an endless list of contingencies, the modern commercial sale agreement may have only a few, including an umbrella due diligence contingency. While matters related to title and financing generally retain their own contingencies, nearly all other items are now rolled into the due diligence contingency.

Such a contingency might read as follows: "This Agreement is contingent upon Purchaser, at Purchaser's expense, conducting its due diligence with respect to the purchase of the Property. Purchaser shall have a period of 60 days after the execution of this Agreement, to make such determinations, inspections and investigations as Purchaser deems appropriate, including but not limited to, such matters as economic viability and incentives, soil conditions, access easements, surveys, utilities, structural considerations, mechanicals, real property tax assessments, real property taxes, environmental matters, wetlands, zoning and permits. Purchaser shall have the right, on reasonable notice to Seller and at reasonable times, to enter upon the Property during such period to conduct appropriate testing and to make inspections; provided, however, that all such work shall be performed in a good and workmanlike manner at Purchaser's sole expense. Purchaser may terminate this Agreement at any time prior to the expiration of this Due Diligence Period without penalty by written notice to Seller."

Note that the language of the contingency could easily have concluded after the words "to make such determinations, inspections and investigations as Purchaser deems appropriate." Everything that follows is illustrative, not exhaustive, of what the purchaser may choose to consider during its investigation of the property and the business deal. The final sentence of the contingency does not require the purchaser to demonstrate cause or even provide any reason for termination. Simply give notice,and you are out of the deal without penalty (and with your deposit refunded). Such a contingency more honestly and accurately reflects the status of the deal during the due diligence period, namely, the seller is bound and the purchaser is not.

Unless you are fortunate enough to be a seller with a unique property and competing purchasers, this is a situation that you are not likely to be able to change. For most sellers, except in the case of a truly speculative deal with a very long lead time between agreement and closing, the nonrefundable deposit is a thing of the past. ☆

For more information on due diligence in real estate transactions, contact J.W. Alberstadt, Jr. at MacDonald, Illig, Jones & Britton, LLP at 814/870-7750 or jalberstadt@mijb.com.

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