STEVEN G. WOOD, *Of Counsel*
Phone: 650.517.5509
Mobile: 650.670.7276
Fax: 650.365.6225
Email: *swood@grayduffylaw.com*

Is the Buyer's Offer Sharp Enough?[1]

Sharp Offers ~ Multiple Offers ~ Escalator Clauses ~ Sample Escalator Clause

When the residential housing market overheats, with shrinking inventories, multiple offers, bidding wars and sizzling sale prices, buyers often take desperate measures. Not satisfied with traditional contractual constraints, such buyers may surrender their right to choose the ultimate sales price and approve their agent's submission of a "sharp offer."

A "sharp offer," aka "relative bid," modifies the traditional offer-acceptance process by appending an "escalator clause" as an addendum to the purchase and sale contract. This means the contract either does not have a specific price as the offering amount, or the addendum accelerates the price automatically based on other bids seller receives usually accompanied by a cap to the price the buyer is willing to pay.

For example, a seller gets 30 offers. The buyer who writes a relative bid usually appends the contract with a clause which states that his or her offer will be $3,000 more than the highest priced offer. It could be a sum certain or even a percentage. What risks does a sharp offer pose?

Obviously, an offer without a price may not be enforceable – it may be a contractual nullity, since, as discussed below, contracts require a degree of specificity to be binding. Why would a seller take a null, or possibly non-binding, offer? If a buyer does not know the actual offering price, does not the buyer submit a blind offer?

Sometimes the top offer has the worst terms. If the offers are all in a price band, but one is spiked due to terrible terms (e.g., "other home sales contingency" or an FHA backed offer with a *de minimis* down payment), the relative bid buyer subjects his relative bid to a sham offer which may never close. Price quantum alone rarely matters, when the qualitative terms are deficient.

The REALTORS® Code of Ethics

When a listing agent receives multiple offers, what can be disclosed to a buyer's agent? Does the REALTORS® Code of Ethics prevent listing agents from disclosing the details of the other offers unless all parties involved are given the same information?

[1] © 2018

Article 1 and its *Standards of Practice* provide guidance on multiple offers. Article 1 has two primary obligations. First is the requirement that REALTORS® "protect and promote the interests of their client." Second is the "obligation to treat all parties honestly." *Standard of Practice 1-15* addresses REALTORS®' obligation in multiple-offer situations: "REALTORS®, in response to inquiries from buyers or cooperating brokers shall, with the sellers' approval, disclose the existence of offers on the property." This Standard of Practice requires disclosure of multiple offers, with the seller's permission, if a buyer or cooperating broker asks about the existence of multiple offers. *Standard of Practice 1-13* addresses disclosure of the offers' terms. "When entering into buyer/tenant agreements, REALTORS® must advise potential clients of: … 5) the possibility that sellers or sellers' representatives may not treat the existence, terms, or conditions of offers as confidential unless confidentiality is required by law, regulation, or by any confidentiality agreement between the parties."

In other words, terms of offers can be disclosed to competing buyers or their agents by sellers or seller's representatives, unless there are laws or confidentiality agreements that specifically prohibit such disclosure. Of course, Confidentiality Agreements between buyers and sellers are more common in commercial transactions than in residential transactions.

Applicable Legal Principles

1. Communication with inadequate terms usually is not an offer.

A document that does not contain the essential terms for a contract often is construed as merely a nonbinding, preliminary agreement. *Peterson Develop. Co. v. Torrey Pines Bank*, 233 Cal. App. 3d 103, 115-116 (1991); *Kruse v. B of A*, 202 Cal. App. 3d 38, 59 (1st Dist. 1988).

2. Whether the communication is an offer is a question of fact.

Whether there has been a manifestation of present intent to be obligated usually is a factual question, and all of the language of the proposal, as well as all of the surrounding circumstances, are taken into consideration in determining whether there was such an intent. *Fowler v. Security-First Nat. Bank of Los Angeles*, 146 Cal. App. 2d 37, 47 (2d Dist. 1956).

3. Miller & Starr Comment, 1 Cal. Real Est. § 1:16 (3d ed.).

> In the case of multiple offers, there are serious practical problems when the parties do not clearly express their intent that the communication will not be an offer. In a marketplace in which buyer demand exceeds the supply of housing, it is common for several buyers to make offers to purchase the same property. The seller can accept any one of the offers, but, in some cases, the seller wishes to make a counteroffer. If the seller is not careful and makes two or more counteroffers to separate buyers, there is a risk that two or more buyers may accept the counteroffers. The seller would then be obligated to sell the same property to two or more buyers.

> In such cases, the seller should either request new and improved offers from each of the buyers or clearly specify that the "counteroffer" is not an offer but only a solicitation for an offer. In the alternative, the seller could provide that no acceptance is effective until it is received by the seller and that the seller can revoke the "counteroffer" at any time prior to the seller's receipt of the acceptance. A counteroffer to two or more offerees that provides for an acceptance of the highest bid is binding on the counterofferor. (Footnotes omitted.)

4. Controlling Authority: *Carver v. Teitsworth,* Cal. App. 4th 845 (1991)

In a civil action arising from multiple sealed bids for real estate made in response to the seller's offer to accept the highest sealed bid, the appellate court held that the trial court erred in determining a bid for "$1,000 more than any other sealed bid" was fatally defective and in granting summary judgment for specific performance to another bidder.

The price the "$1,000 more" bidder was willing to pay was subject to objective determination, i.e., $1,000 over the highest certain bid. Also, a relative bid may be valid, but only where a party expressly solicits relative bids or such bidding is objectively reasonable as customary in a particular trade or industry. Factually, none of the other parties contemplated a relative bid, but a triable issue of fact remained whether the relative bid was reasonable under the circumstances. *Carver v. Teitsworth*, supra, 1 Cal. App. 4th at 851-852 cited with approval in *Sterling v. Taylor*, 40 Cal.4th 757, 774 (2007); accord *Cal. Lettuce Growers v. Union Sugar Co*., 45 Cal.2d 474, 482–483 (1955) (holding that a price term may be calculated from a formula where a price formula was derived from industry custom and the parties' past practice).

California law is clear that if the price may be objectively determined, a contract in which the price is not expressed may nonetheless be enforced. *Carver v. Teitsworth*, supra, putatively upheld the validity of "sharp offer" real estate bidding:[2]

a. If price may be objectively determined, a contract in which price is not expressed may nonetheless be enforced. Id at pp. 852-854.

---

[2] 1 *Witkin, Summary 10th (2005) Contracts , § 292, "Relative Bids"* p. 319 interprets the *Carver* case as follows:

Carver v. Teitsworth (1991) 1 C.A.4th 845, involved a procedure whereby the sales price of property offered for sale by Teitsworth was to be determined by sealed bids at a price not less than $795,000. Of the three bids received, two listed specific amounts, while the third, submitted by Carver, promised to pay $1,000 higher than any other bid. Held, relative bids—known as "sharp bids"—constitute a fraudulent practice unless they are either expressly solicited or objectively reasonable as being customary in a particular trade or industry.

(a) If relative bidding is concealed, it defrauds the sum-certain bidders by inducing them to submit bids that are necessarily ineffective and that guarantee the relative bidder's supremacy. However, if the practice is known to be allowed, the fraud by concealment disappears and the question becomes one of business practicality, not fraud. In other words, unconcealed relative bidding would either be abandoned as unworkable or sellers and bidders would adopt protective ground rules to make it workable. (1 C.A.4th 854, citing, and adopting the position of, a Minnesota decision.)

(b) Here, there was evidence that Teitsworth's broker had no idea what to do when he opened Carver's bid, thereby indicating that Teitsworth and the sum-certain bidders neither requested nor contemplated the submission of relative bids. However, the record is silent on the separate question of whether the parties reasonably should have anticipated these bids. The answer may depend in large measure on expert evidence of custom and practice in the real estate industry. (1 C.A.4th 855.)

b. A sealed bid for bidder to pay "$1,000 more than other sealed bid" resulted in objective price determination, and bidder's claim was not defeated by claims that on grounds that any such contract was not certain enough as to price to be enforced. Id.

c. Relative bids may be valid, but only if party expressly solicits relative bids or such bidding is objectively reasonable as customary in the trade or industry. Id at p. 854.

d. Summary judgment was denied against the prospective buyer, who submitted a sealed bid for "$1,000 more than any other sealed bid" in an action for specific performance and declaratory relief, although neither seller nor the otherwise highest bidder was aware that a relative bid would be submitted, and record was insufficient to determine if the bid was defective. Id at p. 855.

How It Works

An escalation clause is when a buyer is willing to go over the highest offer, up to a specified amount. A buyer's escalation clause is triggered by a competing offer. When that competing bid is made, the escalation clause automatically increases its own offer by a preset amount. The clause limits (or "caps") the buyer's maximum bid. For the clause to be triggered, the seller should be required to prove there was another bona fide offer.

A copy of a competing offer serves as the proof needed to trigger an escalation clause. But in practice, such proof can be problematic. A leap of faith is required that competing offers are legitimate, since they can be fabricated to force a buyer with an escalator clause to pay the ceiling price. Such behavior is unethical, but happens. Even if all offers are legitimate, buyers should not take anything at face value.

Sometimes a competing offer may be for a price the seller wants, say $300K, but also includes $10K in seller paid buyer closing costs, so it is effectively $290K. But the other buyer's actual written offer is for $300K, so the escalation can be interpreted as $310K. Other qualitative conditions can devalue an apparently "high bid" so contingencies must be considered to determine the benchmark offer.

No Guarantee

While an escalator clause supposedly keeps an offer competitive, it does not guarantee that the seller will accept the "sharp offer," even if it is the highest bid. With or without an escalator clause, a seller can accept the offer of their choice: a seller may see a lower cash offer as better than a higher financed offer.

When To Use It

While agents may agree that buyers should only use an escalation clause when multiple offers appear likely, it does not follow that a buyer should use an escalator clause when the market is competitive. Buyers who are ambivalent about a particular house, but just want to purchase so they are no longer renting, may find themselves feeling frustrated after "losing" a few times. But getting desperate and just offering more may be imprudent. Such buyers can keep tendering offers and save the escalation clause for a home they love.

Appraisal Value

An escalator clause may help win a bidding war, but it may open a buyer up to another problem: offering more than the appraised value. If an offer is above asking price and waives the appraisal valuation, the agreement is to purchase the home regardless of appraised value. If the lender's appraisal is lower than the amount offered, the "escalated buyer" will pay the difference. For such reason, it is a good idea for buyers to write an escalator clause which retains an appraisal contingency, meaning that the actual purchase price will conform to the lender's appraisal.

Escalator Clauses

"Sharp offers" have sprung up again, during the current booming market so may be deemed objectively reasonable as customary in the current residential market, the key questions will be contextual vis-à-vis the transactional disclosure to other prospective buyers, the use of an appraisal contingency (often lacking in many such clauses), and the qualitative and quantitative standards for the "bona fides" of the competing benchmark offer (again, often lacking).

As the *Witkin* commentators, supra, state: "If relative bidding is concealed, it defrauds the sum-certain bidders by inducing them to submit bids that are necessarily ineffective and that guarantee the relative bidder's supremacy. However, if the practice is known to be allowed [in the specific transaction], the fraud by concealment disappears and the question becomes one of business practicality, not fraud."

Accordingly, a "sharp offer" addendum can be *per se* proper, if artfully drafted and used in the correct transactional manner, to wit, with fair and full disclosure to the bidding pool so that relative bidding is either abandoned as unworkable or sellers and bidders adopt protective ground rules to make it workable for each transaction.

Consistent with the foregoing analysis and authorities, the sample Escalator Clause, below, includes: (i) a disclosure of the relative bidding process, in accordance with the holding in the *Carver v. Teitsworth* opinion, (ii) alternative appraisal contingency language, and (iii) clarification of the quantitative and qualitative standards for a "bona fide benchmark offer."

MULTIPLE OFFER / ESCALATOR CLAUSE
ADDENDUM TO REAL ESTATE PURCHASE AGREEMENT

The following is made part of the Real Estate Purchase Agreement between_____ (Seller) and _____(Buyer) for the property located at _____ (Subject Property). The purchase price shall be ($_____), _____ Dollars.

If multiple offers are made, Seller's agent agrees to inform the agents of all offering parties that a relative bid has been made. Buyer agrees to pay ($_____), _____ Dollars more than the highest competing offer(s) to the Seller on or before _____, to a maximum purchase price of ($_____)._____ Dollars (Escalated Offer).

[__] If an Escalated Offer is above asking price, Buyer waives the appraisal valuation and agrees to purchase the Subject Property, regardless of the appraised value. If the lender's appraisal is lower than the amount offered, Buyer will fund the difference.

OR

[__] The Escalated Offer shall conform to the lender's appraisal as a necessary contingency.

Seller agrees to provide Buyer with a copy of the competing "bona-fide benchmark offer." As used herein, the term "bona-fide benchmark offer" means an amount net of any setoffs against the actual amount that Seller will realize from the benchmark offer, but not an offer spiked as a result of terms (such as a contingency on a home selling or an FHA backed offer with a minimal down payment), such that Escalated Offer is subject to a benchmark offer, which may never be accepted and closed upon.

All other terms and conditions in the Real Estate Purchase Agreement shall remain the same.

Buyer_____Date_____

Seller _____ Date _____