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# **Litigation Considerations, Part 3: Buyout Provisions**
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*This article—the last in Adrienne Koch's three-part series examining common features of real estate transactions that can benefit from a litigation analysis in the negotiation phase, she explores the reasons why, and suggests some drafting considerations.*

Real estate joint ventures often include a contractual provision for one side to buy the other out under certain circumstances. Although these provisions vary widely, one feature they share is that their purpose is to end the relationship. As a result, when they are invoked the parties are often at odds. It should therefore come as no surprise that they can give rise to litigation.

Such litigation frequently involves an attempt by one party to enforce the terms of the buyout provision through specific performance. But that remedy may be less readily available than the parties might assume. This article—the last in a three-part series examining common features of real estate transactions that can benefit from a litigation analysis in the negotiation phase—explores the reasons why, and suggests some drafting considerations.

## **Types of Buyout Provisions**

First a brief primer on buyout provisions, which fall into two categories: the "buy-sell" provision and the "put" or "call" provision. Either type may function as a dispute resolution mechanism, in which the agreement specifies that a party may invoke the provision if a particular type of dispute arises and is not resolved through some other specified means. But the agreement may also (or instead) specify that the provision can be invoked after a certain date, or following the achievement of a particular milestone.

To invoke a buy-sell provision, one party delivers a notice that gives the receiving party the option either to purchase the noticing party's interest in the venture or to sell its own interest to the noticing party. Some agreements provide that the price for the purchase or sale is whatever the noticing party specifies in the notice; others provide that the price is that amount with certain specified adjustments; still others set forth a formula or procedure for valuing the interest. The common thread, however, is that the price for a sale is the same as the price for a purchase, with the offeree deciding which of these two will occur: a sophisticated version of the "I cut, you choose" rule.

A put or call provision, in contrast, gives one party a right to require the other to purchase (a put) or to sell (a call) its interest. Once the right is exercised, the purchase/sale price is

determined by a formula or procedure set forth in the agreement. Many versions of this type of provision require a party to irrevocably exercise this right before it knows for certain what the price will be.

**Specific Performance and Other Remedies**

In a perfect world, when a buyout provision is triggered one party will be bought out and the other party will carry on with the venture. But this does not always happen. A party that has bound itself to purchase or sell before the price is determined may ultimately balk at the price, or a party that is obligated to buy may refuse (or be unable) to do so. What happens in that event?

One possibility is a suit for specific performance, asking a court to direct the recalcitrant party to comply with its obligations. In fact, many buyout provisions specify that they are enforceable in this manner. But saying that does not always make it so. Although a contractual provision stating that a buyout mechanism is enforceable through specific performance might weigh in favor of granting that relief, it is not dispositive: courts may still deny specific performance if they conclude that the legal or equitable requirements for that relief are not met. This is not always a straightforward analysis.

For example, a party seeking specific performance must demonstrate that it has no adequate remedy at law. *See Van Wagner Advertising Corp. v. S&M Enterprises*, 67 N.Y.2d 186 (1986). Although such inadequacy is generally presumed where the underlying agreement involves a conveyance of real property, that presumption does not apply where the asset being conveyed is an interest in a venture that owns real property. See *Kheel v. Kheel*, 72 A.D.3d 1543, 1544 (4th Dept. 2010) (collecting cases). Such an interest may nevertheless be sufficiently unique to support a claim for specific performance of an obligation to sell it (*see Matter of Fontana D'Oro Foods, Inc.*, 65 N.Y.2d 886, 888 (1985)); however, here the terms of the buyout provision may come back to haunt the would-be buyer.

Here is why. Under Delaware law—which (as noted in the second article in this series) parties often choose to govern their real estate ventures—specific performance is likely available to enforce a contractual procedure for valuing a party's interest in connection with a buyout provision. *See Walsh v. White House Post Productions*, 2020 WL 1492543 (Del. Ch. Mar. 25, 2020).

But once that procedure has yielded a price, it is not clear that specific performance will be available to require an actual sale: the procedure may be considered "the equivalent of calculating money damages," making specific performance unavailable. *See Manchester v. Narragansett Capital, Inc.*, 1989 WL 125190, *5 (Del. Ch. Oct. 19, 1989); *accord Van Wagner*, 67 N.Y.2d at 193 ("[t]he point at which breach of contract will be redressable by

specific performance thus must lie not in any inherent physical uniqueness of the property but instead in the uncertainty of valuing it").

This principle likely applies only where the agreement actually includes a valuation methodology, not (for example) where it allows the party issuing a buy-sell notice to name its price. But using such a methodology may have the unintended effect of limiting the would-be purchaser to a damage remedy if the would-be seller refuses to sell. Although it can certainly be argued that monetary damages will not make the would-be purchaser whole because they leave the parties in business together, if the valuation methodology includes any kind of control premium it becomes harder to argue that it is not also a proper measure of damages. This may not be a reason to avoid using such a methodology, but parties that do so should be aware of this issue—and may wish to consider (for example) specifying that the methodology values only the interest itself, and that the consideration for control of the venture is something additional and non-monetary such as the buyer's assumption of the seller's responsibilities in the venture.

Another complicating factor is that a court will not award specific performance if the defendant is not "capable of complying." *See Edge Group WAICCS LLC v. Sapir Group LLP*, 705 F. Supp.2d 304, 319 (S.D.N.Y. 2010) (applying New York law). This means (for example) that if the would-be purchaser lacks the funds to complete the purchase, the court may refuse to direct it to do so (and, of course, the seller may be unwilling to transfer its interest in exchange for an I-O-U from such a purchaser).

As well, numerous other circumstances may impair a party's ability to convey or acquire the interests. To account for such circumstances, agreements often provide alternative remedies such as liquidated damages, a right to purchase the defaulting party's interest at a substantially-discounted price, or even a right to require a sale of the entire venture.

By contractually expanding the universe of available remedies in this way, parties make it less likely that they find themselves stuck with a choice between a remedy they did not anticipate or no remedy at all. Under New York law, however, the availability of liquidated damages will not preclude a claim for specific performance unless the agreement specifies as much. In fact, absent such a specification a court may actually award both specific performance and liquidated damages. *See*, *e.g.*, *World Gold Trust Services, LLC v. GoldCoin Developers Group LP*, 2021 WL 4134681, *4 (S.D.N.Y Sept. 10, 2021) (applying New York law). As a result, parties should take care to make clear whether or not they intend that liquidated damages will be a substitute for all other remedies.

**Conclusion**

Through buyout provisions, parties who may have no present intention of ending their relationship agree to the terms on which they will do so if the circumstances change. Once

invoked, if they are followed (either voluntarily or through an award of specific performance) then the parties will be “divorced” in exactly the way they agreed. But if they fail, the parties may find themselves relegated to damage remedies and bound to continue in the relationship.

Careful consideration of these matters at the outset (together with steps to ensure that, at the time enforcement is sought, the other requirements for specific performance are met—including that the party seeking that remedy has fully complied with its own obligations and has not engaged in inequitable conduct) can help to minimize the risk of such an outcome.

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