New York High Court Determines How to Measure Damages When Buyer Defaults
White v. Farrell
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The New York court system is broken up into four separate Judicial "Departments" so that there is a First, Second, Third and Fourth "Department" divided geographically. The New York State Court of Appeals on March 21, 2013 rendered a decision in which it has defined how to measure a seller's damages for a buyer's breach of contract in the sale of real property. The Four Departments had reached similar conclusions using different theories of law. New York's High Court has now placed the State of New York amongst the rest of the fifty states upon holding that, "the measure of damages is the difference, if any, between the contract price and the fair market value of the property at the time of the breach." The Court went on to also state that a trial court could make a determination about the amount of the loss that included taking into account "[t]he price obtained by the seller on a later resale of the property…".

The Facts in White v. Farrell

Dennis and Nancy Farrell owned a home on Lake Skaneateles, New York. The Farrells had purchased the property in 2002, tore down the existing structures and built a year-round single family home. In May of 2004 they decided to sell their new home having decided to relocate to South Carolina. The Skaneateles house was not completed until a Certificate of Occupancy was issued on May 31, 2005, a year after the Farrells first listed the property for sale.

Shortly after the Certificate of Occupancy was obtained, the Farrells showed the property to Leonard and Paula White (Leonard subsequently passed away). On the day the Whites saw the property (June 12, 2005), they offered to buy it for $1,725,000.00, the full asking price. They put $25,000.00 down on the Contract and the balance was to be paid in cash at a closing to be held on July 10, 2005. The Contract included a number of clauses regarding satisfactory inspections, resolution of some construction related items, including one identified as "drainage finished" and the approval by the respective attorneys of the contract prepared by the brokers. The Farrells countersigned the contract on June 13, 2005. Although the Certificate of Occupancy had been issued, the property was still under construction because of the need to divert surface water away from the house. The water was also traveling onto the leach field for the raised bed septic system and the ground was soggy.

A real estate agent, Linda Roche, was involved in listing the property. Another agent brought Leonard and Paula White to the property. Two days after the contracts were countersigned, Mr. Farrell wrote to broker Roche that he was prepared to either fix or credit the Whites "to make the house as close to what he wants as possible." He

proposed a specific project that might take five or six weeks to complete. He also suggested that he lived too far away to hire or monitor contractors and would prefer to simply reduce the contract price by $10,000.00 so that the Whites might choose to make whatever changes or completions were necessary. After the broker, Ms. Roche, conveyed this information to the broker with whom the Whites were working, Ms. Roche retained a plumber and septic system expert to investigate and remedy the water drainage problems. She at all times kept the White's real estate agent apprised of her progress.

Contract Contingencies Released

The Whites had the house inspected and their attorney approved the form of contract subject to confirmation that real property taxes would be less than $30,000.00 per annum. The parties elected to execute an addendum to the contract and all contingencies in the contract were eliminated provided that the sellers, the Farrells, completed certain tasks, including the completion of the drainage system and to provide the $10,000.00 credit for other matters. No timeframes were set or deadlines established for the completion of the work the Farrells agreed to undertake.

The Buyers Default

Two weeks later by letter from the attorney for the Whites, the Farrells' attorney was notified that the Whites had elected to "terminate the Contract because upon closer inspection…the drainage system (might) never be rectified." The attorney for the Whites indicated that Mr. White had toured the site that day with his construction consultant and that they no longer wanted to proceed. The Farrells' attorney responded by outlining what had been done to date and characterized the Whites action to terminate the Contract as a "fabricated reason to cancel the contract." On July 13, 2005 the Whites' attorney communicated that the Whites had no intentions of going forward with the contract. On October 4, 2005 the attorney for the Farrells sent a time of the essence letter to the Whites' attorney declaring October 24, 2005 as the "Law Date" at which the Whites would have to appear and close. The Whites did not respond nor did they show up for the closing. In fact, they had signed another contract for the purchase of a different piece of property on Skaneateles Lake on July 23, 2005 and paid $1.7 Million for the second property on August 24, 2005 when they closed.

The Buyers Want Their $25,000.00 Returned

Almost one year later, the Whites sued the Farrells to recover their $25,000.00 downpayment alleging fraudulent inducement, negligent misrepresentation and asserting that the Farrells were never ready, willing and able to close on the Law Date in October 2005. During the discovery process, the broker Ms. Roche was deposed by the buyers' attorney. She testified that she had worked as a broker in the Skaneateles area since 1980, was an expert in lake properties and that real estate appraisers and bankers looked to her when they wanted an accurate estimate of value. She stated her opinion

that the $1.725 Million price was the fair market value of the Farrells' property when it was first listed in May of 2004, that it continued to be valued at that price in June of 2005 when the contract between the Whites and the Farrells was signed, that it remained at that price in July of 2005 when the Whites repudiated the contract and similarly in October 2005 (the Law Date), the property value remained at $1,725,000.00.

The Sellers Find a New Buyer

While the lawsuit between the Farrells and the Whites was pending, the Farrells finally accepted a purchase offer of $1,376,550.00 from a third party. They conveyed the property to the third party on March 9, 2007. The Farrells sought $348,450.00 in damages representing the difference between the original contract price of $1,725,000.00 and the eventual sale price of $1,376,550.00. They also sought consequential damages of $217,636.88 representing the sum of the mortgage and tax payments made on the property from July 7, 2005 until the closing with the ultimate purchaser on March 9, 2007. The original purchasers, the Whites, opposed all of the motions made by the Farrells and simply demanded the return of their $25,000.00 payment.

Decision by the Trial Court

On February 9, 2010 the Supreme Court handed down a decision concluding that the Whites had breached their contract, that they were not entitled to a refund of their $25,000.00 payment and based upon a prior decision in the Third Department (in which Skaneateles is located) the Court stated that the actual damages were equal to the "difference between the contract price and the market value of the real property at the time of the breach." Based upon broker Roche's deposition, the judge concluded that the price had not changed and that the Farrells did not suffer any actual damages. He also threw out the Farrells claim of consequential damages as being "not valid". The Farrells appealed to the Appellate Division Third Department which unanimously confirmed the decision of the Trial Court.

The New York State Court of Appeals decided to grant to the Farrells leave to appeal to the State's highest court.

Decision by the New York State Court of Appeals

The New York State Court of Appeals thoroughly analyzed decisions regarding similar circumstances following the default by a buyer in a real estate transaction. Such decisions had been made in each of the four Departments throughout New York State. The Court also went into detail about the theoretical basis for the different concepts applied by the courts including the right of the parties to contract away their rights to determine damages before the court. Most contracts in our metropolitan area of New York City have a "liquidated damages" clause which indicates that the 10% downpayment customarily paid by the buyer to the seller would constitute the sole damages to which the seller might become entitled as and for "liquidated damages".

Many decisions that have been made by the courts throughout the State were reviewed along with various concepts set forth in law books or treatises on the subject of contracts and the measure of damages. The Court noted that the standard commonly used throughout the United States is the difference between the contract price and the fair market value of the property at the time of the breach. What complicates this simple statement is the additional concept that the "price obtained by the vendor on a later resale of the property may be regarded as competent evidence of its fair market value on the date of the purchaser's breach, provided that the market conditions are similar and the time elapsed between the date of the breach and the date of the resale is not too great." (13 Lord, Williston on Contracts, §66.80 [4th Ed]).

Why the Court of Appeals Decided to Take this Case

In accepting this case for review, the judges of the Court of Appeals noted that it had "never before considered the measure of damages for a buyer's breach of a contract to sell real property." It noted that the Four Departments had consistently endorsed the "time-of-the-breach-rule". At the same time the Court noted that there were cases where it was not made clear that the rule was being applied and many cases did not state that the resale price can be used as evidence of the property's fair market value at the time of the breach.

The Farrells of course argued that the value at the time of the breach was irrelevant and the actual price that they received fourteen months later should constitute the measure of damages incurred. The court also did a very thorough analysis of a failed attempt to create a national standard for measuring damages in breach of contract cases under what was known as the Uniform Land Transactions Act (ULTA) which had been proposed in 1975, was initially approved by the National Conference of Commissioners on Uniform State Laws but was never adopted by any state. It was finally withdrawn from the National Conference of Commissioners in 1990.

The Court concluded that the measure of damages should be the difference between the original contract value and the value at the time of the breach. The loss should be offset by any funds forfeited by the purchaser pursuant to the terms of the contract or paid on account of the contract. The Court noted however that "fair market value at the time of the breach" is a question of fact. The Court also determined that summary judgment should not be utilized when there is a question about the fair market value at the time of the breach. The Court questioned whether the Realtor's (Ms. Roche's) testimony should be persuasive. They therefore returned the matter to the Supreme Court for a determination as to what the true value of the property was at the time of the breach. The Court noted that it was 14 months from the time of the essence date to the actual sale of the property. The High Court stated that the Trial Court should have taken into account any differences in market conditions, contract terms and other factors including whether the Farrells "made sufficient efforts to mitigate (i.e., to resell at a reasonable price after the Whites' default), which is relevant to any weight to be given to the resale

price as a measure of fair market value at the time of the breach…" In the case of the Farrells and the Whites, the Court also suggested that the actual cost to remedy the property's drainage deficiencies would have to be subtracted from the contract price of $1,725,000.00 "in order to establish the contract price to be compared to the property's fair market value in October 2005."

Conclusion

The determination in this case gives buyers, sellers, appraisers and attorneys firm ground on how to go about pursuing damages in the event of a buyer's breach of contract. At the same time, it also encourages agreement to liquidated damages clauses so that such litigation becomes unnecessary. Given the fact that there are numerous considerations to which any court can look, such as changes in market conditions, the timeframe between the time of default and issuance of a time of the essence letter, the timeframe between the law date (the date on which the default is deemed to have occurred) and the actual ultimate sale date, it seems preferable to seek a liquidated damages arrangement for the purposes of certainty and simplicity.

It is interesting to note that the standard form contract used in our area and which was adopted by the Real Property Law Section of the New York State Bar Association, includes the following liquidated damages clause:

> **"Defaults and Remedies.** (a) If Purchaser defaults hereunder, Seller's sole remedy shall be to receive and retain the Downpayment as liquidated damages, it being agreed that Seller's damages in case of Purchaser's default might be impossible to ascertain and that the Downpayment constitutes a fair and reasonable amount of damages under the circumstances and is not a penalty.
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> (b) If Seller defaults hereunder, Purchaser shall have such remedies as Purchaser shall be entitled to at law or in equity, including, but not limited to, specific performance."

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