



LEGAL UPDATE

A MONTHLY GUIDE TO WISCONSIN REAL ESTATE LAW & POLICY

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Price Escalation Clauses and Multiple Counter-Proposals

When a real estate market exhibits low inventory coupled with high demand, it sets the stage for a seller's market. Price escalation clauses and multiple counter-proposals are two negotiation strategies that buyers or sellers may use during a seller's market. A buyer can use a price escalation clause as one negotiation tool when competing with other buyers or when attempting to make the buyer's offer as attractive as possible for the seller. A seller can use one or more multiple counter-proposals to engage in non-binding negotiations with one or more buyers at the same time.

Price Escalation Clauses

A price escalation clause is a provision in an offer to purchase where the offered price may be determined by another offer to purchase. A buyer may use a price escalation clause when the buyer is aware of or suspects there will be competing offers on a property. For example, a listing agent may advertise a property and indicate that the seller will review all offers on Sunday following a Saturday open house. In that scenario, in a seller's market, a buyer may logically conclude that there will be other interested buyers writing offers on that property. A buyer in that situation may choose to include a price escalation clause in the offer. When the seller considers the offers on Sunday, there may be several offers for the seller to review. The buyer who included a price escalation clause can be hopeful that the price escalation clause will raise the buyer's offered price above the offered price in the other offers.



REALTOR® Practice Tip

Price escalation clauses are also sometimes called escalator clauses or acceleration clauses. The use of the term "acceleration clause" is not entirely accurate as that has a different meaning in the context of a loan. A more precise term for an escalation/acceleration/escalator clause may be "price escalation clause" because the price that is being escalated based on another offer.

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REALTOR® Practice Tip

The term "acceleration clause" is more appropriately used to describe a contractual clause in a credit agreement or loan that requires a debtor to pay the balance of a loan sooner than originally agreed. Acceleration clauses are frequently triggered by delinquent payments. For example, an individual owes \$2000 to be paid back \$200 per month at 0% interest. The loan terms contain an acceleration clause. The individual pays Month 1 payment of \$200 but does not pay Month 2. The acceleration clause in this example means that the full balance of \$1800 is due immediately after the first missed payment even though the original term of the loan was 10 months.

Drafting the price escalation clause

There are many different ways to draft a price escalation clause. Typically, the price escalation clause will include a window of time during which the price may be escalated due to the price of another offer. The window of time for escalating the offer price may match the window of time for binding acceptance. The price escalation clause will also include the amount by which the offer is increased based on other offers submitted during the window of time for escalation. A price escalation clause will also typically include an escalation cap, which defines the upper limit of the price range that the buyer is willing to pay for the property. A buyer including a price escalation clause will also typically want to include some sort of verification process for the escalating price such as receiving a copy of any offer that is triggering the escalation.

Example

A buyer's offer, Offer #1, is for \$200,000 and has a deadline for binding acceptance of March 31. It includes a price escalation clause stating that the buyer will increase the buyer's offered price by \$2500

over any offer submitted to the seller prior to midnight on March 31 up to a maximum of \$212,500. For the escalated price to be enforceable, the seller agrees to deliver a copy of any offer triggering the escalation clause to the buyer. When the buyer delivered Offer #1, the seller already had an offer for \$205,000, and at 5:00 p.m. on March 31, the seller received an offer for \$207,000, Offer #2. The seller signed Offer #1 at 6:00 p.m. and delivered it to the buyer at 7:00 p.m. on March 31, creating binding acceptance. The seller and the buyer have an accepted offer to purchase with a purchase price of \$209,500. When the seller delivers the accepted offer to the buyer creating binding acceptance, the seller also delivers an amendment stating that the purchase price is \$209,500 along with a copy of Offer #2 showing the \$207,000 purchase price.

The following is a sample of a basic, bare bones price escalation clause the WRA created for buyers to use in a situation where a price escalation clause is desirable. It can and should be modified as needed.

If Seller receives any other bona fide offer on Property prior to _____ (date), with a net price (purchase price minus any monetary contributions by Seller) equal to or higher than \$_____, Buyer agrees to pay \$_____ more than said offer, up to a maximum of \$_____, provided Seller delivers a copy of offer directly to Buyer within 2 days of receipt of said offer. Upon acceptance, Buyer and Seller agree to amend purchase price, per the above stated terms, via amendment (WB-40).

Buyer and Seller are aware that Wis. Admin. Code § REEB 24.12 prohibits a licensed real estate agent from disclosing any of the terms of one prospective buyer's offer to purchase, exchange agreement or option contract proposal to any other prospective buyer or to any person with the intent that this information be disclosed to any other prospective buyer.

Buyer and Seller understand that delivery of other bona fide offers must be conducted solely between Buyer and Seller and cannot involve their respective agents.

REALTOR® Practice Tip

There are many different ways to correctly, and incorrectly, draft a price escalation clause. A buyer or seller with questions on drafting or interpreting a price escalation clause should be referred to an attorney.

Triggering the price escalation clause

In the escalation clause provided as an example, the price increase is triggered by another buyer submitting an offer to the seller at or above the buyer's price. In this example, the seller will provide the buyer with a copy of the other buyer's offer to trigger the price increase. The seller provides the document, not the licensee, because the licensee must observe the duty of confidentiality to the other buyer. Alternatively, a price escalation clause may provide for another process for triggering the escalation clause such as having an attorney review the offers and provide the purchase price to the buyer with the price escalation clause.



Adjusting the purchase price

Should the parties use an amendment or a notice to change the purchase price when the increase is due to the price escalation clause? It depends. When the buyer drafts the price escalation clause, the buyer should indicate how any price change would be documented and thus set the mechanism by agreement of the parties. Whether the parties use an amendment or a notice depends on the language included in the price escalation clause. With either the notice or the amendment, the parties are only changing the purchase price.

In the provided example of a price escalation clause, the parties agree to use an amendment to adjust the purchase price. An amendment has the advantage of confirming that both parties agree to the price modification. A notice could be used if the price escalation clause language stated that such a notice would be effective to modify the terms of the offer to purchase. A buyer may not be willing to give a seller the unilateral power to change the price. Lenders and others looking at the offer would clearly understand an amended price but may be puzzled and unwilling to rely on a notice unless that protocol was established in the contract language.

The parties do not have to amend the terms of the financing contingency because those terms already anticipate and address some fluctuation in price either at or during the initial negotiations or to address events such as damage or discovery of defects that occur after binding acceptance. Lines 224-226 of the WB-11 Offer to Purchase state "If the purchase price under this Offer is modified, the financed amount, unless otherwise provided, shall be adjusted to the same percentage

of the purchase price as in this contingency and the monthly payments shall be adjusted as necessary to maintain the term and amortization stated above.”



REALTOR® Practice Tip

If there is any ambiguity in the price escalation clause regarding how the payment will be adjusted, the parties can use a counter-offer to clarify the terms of the escalation clause.

A price escalation clause in the buyer’s offer might be the perfect tool to make sure the buyer’s price is better than other competing buyers, but neither the buyer’s desire for the property nor the buyer’s aggressive negotiation will have any effect on the appraisal. Some sellers, when considering offers with a price escalation clause, may try to counter out an appraisal contingency in a buyer’s offer knowing that a purchase price driven up by a bidding war or use of a price escalation clause may not be supported by the appraisal on the property. If the buyer’s offer is a cash offer, countering out an appraisal contingency is a reasonable negotiation strategy for a seller to use. If the buyer’s offer is contingent on financing, countering out the appraisal contingency will not magically erase the inevitability of the appraisal as part of the financing process.

An appraisal that comes in lower than the agreed upon purchase price does not have to be fatal to the offer and is not necessarily fatal to financing. The buyer and the seller could amend the offer to reduce the purchase price, though that solution may be unlikely in a seller’s market where buyers are using price escalation clauses. A lender may still agree to lend to a buyer if the appraisal is lower than the purchase price, but the lender may not lend as much as the buyer was hoping to borrow.

Example

A buyer wrote an offer for \$200,000. The offer is contingent on financing and also includes a price escalation clause. The buyer was intending to borrow \$160,000, and the financing contingency reflects this. The buyer’s price escalation clause is triggered, and the purchase price is increased to the buyer’s maximum of \$212,500. As part of the loan process, the lender orders an appraisal, and the appraisal comes in at \$200,000. The lender may still issue a loan commitment to the buyer but base the offered financing terms on the appraised value of \$200,000. The lender is still offering to lend \$160,000; and to close this transaction, the buyer must bring \$52,500 to closing instead of the original \$40,000 the buyer would have had to bring if the price escalation clause had not been triggered.

Is a price escalation clause the right negotiation strategy?

The first question a buyer must ask before submitting an offer with a price escalation clause is “Are you sure there are other offers?” If not, submitting an offer with a price escalation clause just told the seller that the buyer is willing to pay more than originally offered. If there are no other offers, a buyer could consider submitting an offer and let the listing agent know that if another offer comes along, the buyer may be willing to counter the buyer’s original offer.

The first question a seller must ask before accepting an offer with a price escalation clause is “Is the highest offer the ‘best’ buyer?” A buyer’s willingness to outbid other buyers does not correlate to the buyer’s ability or willingness to close the transaction. A buyer who outbids other buyers but makes the offer contingent on an appraisal or

financing may end up backing out of the deal at a later date. A buyer who includes a price escalation clause may end up with “cold feet” or “buyer’s remorse” once the negotiations settle down and the buyer considers that he or she might be overpaying for a property. An offer with a price escalation clause can still be contingent on financing, closing of the buyer’s property, appraisal, inspection or any other number of contingencies. For any seller, a lower price offer with fewer contingencies might be a better offer than a higher price offer with many contingencies. Rather than negotiating with buyers presenting offers with price escalation clauses, the seller may ask all buyers to submit highest and best offers in an attempt to elicit the buyer’s highest offer and eliminate the process involved in accepting offers and escalating prices.

An offer with a price escalation clause is a gamble for a seller and for a buyer. A seller who accepts an offer with a price escalation clause might not receive another offer to trigger the first buyer’s escalation clause, which means the price remains what it was in the original offer. A seller could receive another offer during the period of possible escalation, but that offer exceeds the cap in the offer with an escalation clause, which means the escalation clause is never triggered and the seller is stuck with the original offer without an escalated purchase price. A seller could receive multiple offers with price escalation clauses and not have a clear road map for deciding which offer triggers which escalation clause. At first glance, a price escalation clause seems like a terrific advantage for a seller but as with all offers, there are factors in addition to and possibly more important than price that should be guiding the parties’ decision-making in the transaction.

The WB-46 Multiple Counter-Proposal

When a seller receives multiple offers on the seller’s property, the seller has a few options. The seller could accept one of the offers, deliver it back to the buyer and create a binding contract with that buyer. Another option for the seller would be to issue a counter-offer to a buyer and negotiate with just one buyer using counter-offers until they have a meeting of the minds and a binding contract. Another option for the seller is to negotiate with multiple buyers using the non-binding WB-46 Multiple Counter-Proposal. Regardless of whether a seller uses a counter-offer with a single buyer or issues multiple counter-proposals to more than one buyer, the seller is risking some or all of the buyers will drop out and end the negotiation process.

Negotiating with a WB-46 Multiple Counter-Proposal is a three-part process: the seller makes a counter-proposal to the buyer’s offer; the buyer accepts the seller’s counter-proposal; and then the seller accepts the buyer’s acceptance of the counter-proposal, and now the parties have a binding contract. A seller can use multiple counter-proposals to issue non-binding proposals to prospective buyers. The proposal is a statement of terms a seller wants a buyer to include in an offer. The WB-46 Multiple Counter-Proposal gives a seller a viable, legal method to negotiate with prospective buyers without committing to a particular buyer’s offer.

Example

A seller receives three good offers from three buyers. A seller can use multiple counter-proposals to negotiate with the buyers. A seller

could issue one proposal suggesting a different purchase price, another requesting earnest money, and no proposal to the third buyer. A seller does not have to issue proposals to all buyers and can customize each proposal based on the buyer's specific offer. If any of the buyers agree to the seller's proposals, the buyer signs the WB-46 Multiple Counter-Proposal and returns it to the seller. The seller is not bound by any of the returned proposals. If a seller likes the terms of an offer coupled with a buyer's accepted proposal, the seller signs the multiple counter-proposal and delivers it back to the buyer. There is now binding acceptance of the buyer's offer including the terms of the accepted proposal.

The seller's proposed terms

The first line of the WB-46 Multiple Counter-Proposal indicates that the seller is making proposals to one or more other prospective buyers. If a seller is issuing a proposal to just one buyer, the seller must strike language implying that the seller issued proposals to other buyers. Absent the modification, a buyer could misunderstand the number of other buyers with which a seller is negotiating, and a seller could be liable for misrepresentation. A seller might issue a WB-46 Multiple Counter-Proposal to just one buyer out of a pool of offers. A seller may choose to use a counter-proposal even if the seller only has one offer because, unlike a WB-44 Counter-Offer, a WB-46 Multiple Counter-Proposal allows a seller to negotiate the terms of an offer with non-binding proposals.

Buyers may receive different counter-proposals, and any proposal is not binding on the seller until there is binding acceptance. Similar to other negotiation documents including offers and amendments, a seller can withdraw a proposal or a buyer could withdraw an accepted proposal until there is binding acceptance. Each buyer receives an individual WB-46 Multiple Counter-Proposal, even if the seller is proposing the same terms to all of the buyers. No buyer will know the terms of another buyer's proposal. Like offers to purchase, the terms of a WB-46 Multiple Counter-Proposal are confidential.

When completing the WB-46 Multiple Counter-Proposal, the seller references the buyer by name and the buyer's offer by date. The language of this section indicates that the buyer's offer is rejected and that the seller is making a proposal rather than a new offer as would occur if the seller issued a counter-offer instead of a proposal. The seller uses lines 11-20 to present the seller's proposed terms. The seller gives the buyer a deadline to respond to the seller's proposed terms. If the buyer does not respond to the seller by the deadline in this section, negotiations are over.

Lines 1-10

A Multiple Counter-Proposal is being made by Seller to one or more other prospective buyers. The terms of this Multiple Counter-Proposal may differ from the terms of multiple counter-proposals being submitted to other prospective buyers. This Multiple Counter-Proposal is not binding on Seller or Buyer until Seller's binding acceptance per lines 45-47. Seller or Buyer may withdraw their Multiple Counter-Proposal or accepted Multiple Counter-Proposal, at any time prior to binding acceptance per lines 45-47. The Offer to Purchase dated _____ and signed by Buyer, _____, for purchase of real estate at is

rejected and the following Multiple Counter-Proposal is made. All terms and conditions remain the same as stated in the Offer to Purchase except the following: [CAUTION: This Multiple Counter-Proposal does not include the terms or conditions in any other counter-offer or multiple counter-proposal unless incorporated by reference.]

Approval by buyer

If a seller issues a WB-46 Multiple Counter-Proposal to some or all of the prospective buyers, the buyers can accept, reject or counter their individual proposals. The seller-issued proposals are not binding on either party until binding acceptance, which must occur before the date listed on line 33. Time is of the essence unless it is stricken. Lines 33-35 instruct a buyer to use a WB-44 Counter-Offer or a new offer if the buyer wants to suggest terms other than those presented by the seller in the proposal. A buyer should not use the WB-46 Multiple Counter-Proposal for negotiating with a seller. If a buyer agrees to all of the seller's terms included in the proposal, the buyer signs and dates the proposal. Lines 36-39 are for buyer identification, signatures and dates. If a buyer wants to reject or counter the proposal, the buyer indicates this on line 40 by striking the inapplicable choice and initialing. Lines 41-43 are for identifying the presenting licensee and the time and date of presentation.

Lines 30-43

APPROVAL BY BUYER

This Multiple Counter-Proposal by Seller is approved by Buyer. Approval of this Multiple Counter-Proposal is not binding on Buyer or Seller until binding acceptance of this approved Multiple Counter-Proposal by Seller (per lines 45-47) on or before _____, (Time is of the Essence).

NOTE: If the above Multiple Counter-Proposal by Seller is not approved by Buyer in its entirety, do not use this form for a counter-offer by Buyer. Instead, submit a Counter-Offer (WB-44) or a new offer to purchase.

(x) _____
 Buyer's Signature Print Name Here Date

(x) _____
 Buyer's Signature Print Name Here Date

This Multiple Counter-Proposal is (rejected) (countered) STRIKE ONE (Buyer's Initials) _____

This Multiple Counter-Proposal was presented to Buyer by _____ on _____ at _____
Licensee and Firm Date a.m. / p.m.

Acceptance by Seller

If a buyer accepts a seller's WB-46 Multiple Counter-Proposal and returns it to the seller, the seller then decides which, if any, of the returned proposals to accept. Lines 45-47 state that by signing the proposal, the seller accepts the buyer's approved proposal and, to achieve binding acceptance, the seller must deliver a copy of the

accepted proposal back to the buyer in a manner authorized by the buyer's offer before the date included on line 33 of the buyer's approval section. Lines 47-48 caution the seller not to sign and deliver an accepted proposal to a buyer if the seller has accepted an offer unless the proposal relates to a secondary offer. If a seller has an accepted offer from one buyer and delivered an accepted proposal to another buyer without identifying one of the offers as secondary, a seller would have two binding contracts for the sale of the seller's property. Lines 51-53 are for licensee identification and documenting the time and date that the licensee presented the proposal to the seller.

Lines 44-53

ACCEPTANCE BY SELLER

By signing below, Seller accepts Buyer's approved Multiple Counter-Proposal. The terms of this Multiple Counter-Proposal shall be binding on Seller and Buyer if Seller delivers a copy of the accepted Multiple Counter-Proposal to Buyer in any manner authorized in the Offer to Purchase on or before the deadline stated at line 33. NOTE: Seller should not sign below if there is an existing accepted offer unless this Multiple Counter-Proposal provides for a secondary offer.

(x) _____ (x) _____
 Seller's Signature Date Seller's Signature Date

The accepted Multiple Counter-Proposal was presented to Seller by _____ on _____ at _____
 Licensee and Firm Date a.m. / p.m.

① MORE INFORMATION

The WRA has produced many resources to aid REALTORS® assisting buyers and sellers in a seller's market:

- WRA LegalTalks: Escalation Clauses and Multiple Counter-Proposals with Tracy Rucka at www.wra.org/LegalTalks/EscalationClause.
- "The Best of the Legal Hotline: The Market Is Heating Up for Summer – How to Work with Multiple Buyers," in the July 2013 *Wisconsin Real Estate Magazine* at www.wra.org/WREM/July13/Hotline.
- "The Best of the Legal Hotline: Duty Confidentiality," in the January 2012 *Wisconsin Real Estate Magazine* at www.wra.org/WREM/Jan10/DutyConfidentiality.

Also see the text of Wis. Admin. Code § REEB 24.12 at docs.legis.wisconsin.gov/code/admin_code/reeb/24.pdf.

Watch the Legal Update Video Online:



EDITORIAL STAFF

Author

Jennifer Lindsley

Production

Lauren B. Hubbard

ASSOCIATION MANAGEMENT

Chairman

Erik Sjowall

President & CEO

Michael Theo, CAE

CONTACT INFORMATION

Wisconsin REALTORS® Association
 4801 Forest Run Road, Suite 201
 Madison, WI 53704
 608-241-2047
 800-279-1972

LEGAL HOTLINE

Ph: 608-242-2296
 Fax: 608-242-2279
 Web: www.wra.org

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