

Escalation Clauses



What is an Escalation Clause?

- Provision where buyer offers to pay more for a property than another prospective buyer(s) without knowing the price offered by the other buyer(s)
- Example: "The purchase price shall be \$1,000 higher than any other offer"
- Also sometimes referred to as a "relative bid" or "sharp bid"



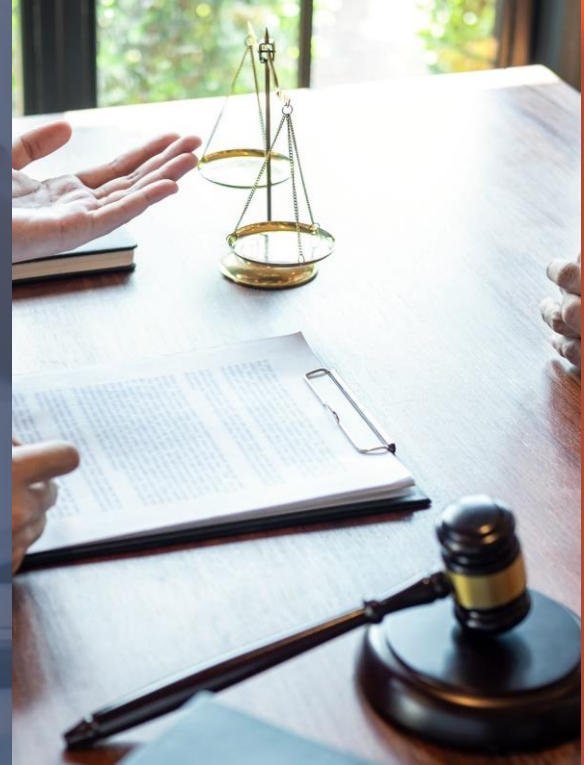
When are Escalation Clauses Used and Why?

- Used when a buyer is looking to make their offer stand out in a multiple offer or competitive market environment
- Allows buyer to make the highest offer, but only by the minimal amount necessary to beat out other offers



Are Escalation Clauses Legal?

- Generally yes, when drafted properly. Escalation clauses can be used to create a binding contract
- Buyer and seller client should be advised to seek legal advice for questions



Including a “Cap” or Maximum Price

- Buyer may offer “XXXX dollars more” than any other offer but “not to exceed” a certain maximum price
- Pro: Limits the buyer's exposure when another buyer makes an outrageously high offer
- Con: Reveals the maximum price at which the buyer is willing to buy (Seller may counter at that maximum price or use it as leverage to get higher offers)
- Bottom Line: Buyer must decide if they want to include a cap, and should seek legal advice about potential consequences

Including a “Floor” or Minimum Price

- Buyer may offer “XXXX dollars or \$1,000 higher than any other offer received, whichever is greater”
- Pro: If no other offers, the seller can accept the buyer’s offer and create a binding contract
- Con: Buyer’s floor price could be higher than the next highest offer, including the escalation amount, causing buyer to pay more than they would otherwise
- Bottom Line: Buyer must decide if they want to include a floor, and should seek legal advice about potential consequences



Requiring Verification of Next Highest Offer

- Buyer should include a requirement that seller provide proof of the highest offer received, with a right to contact the other buyer or their agent to confirm the offer is in fact real
- While agents are often uncomfortable handing over other offers, without the use of a confidentiality agreement, offers themselves are not confidential and may be shared with other agents or prospective buyers

What if Multiple Offers Include an Escalation Clause?

- Unlikely Seller can just accept one of the offers with an escalation clause to create a contract – it may be impossible to determine purchase price
- Seller would be well-advised to issue multiple counter offers



Risk Management Concerns

- Buyers should always be advised to speak with their own legal counsel prior to making an offer with an escalation clause
- Brokers may
 - adopt a policy discouraging the use of escalation clauses
 - adopt a policy that agents may not draft escalation clauses, requiring the buyer to use their own attorney to draft such clauses

Additional Resources

Quick Guide

<https://www.car.org/-/media/CAR/Documents/Transaction-Center/PDF/QUICK-GUIDES/Quick-Guide---Escalation-Clauses.pdf?la=en&hash=4AE878F7D2B9416B9EBB84785F82447048D98D56>

Legal Q&A

<https://www.car.org/riskmanagement/qa/contract-forms-folder/escalationcauses>

Escalation Clauses

What is an escalation clause?

An escalation clause (also called a relative bid or "sharp" bid) is a provision added to an offer or counter offer where the buyer offers "X dollars more" than the next highest offer. For example, an offer that states, "The purchase price shall be \$1,000 higher than any other offer," contains an escalation clause.

Should there be a cap indicating the maximum price? For example, should the buyer offer "XXXX dollars more" than any other offer but "not to exceed" a certain maximum price?

On the face of it, this seems like a good idea since it limits the buyer's exposure to paying an exorbitant price in the event another buyer makes an outrageously high offer. But, on reflection, in the typical real estate scenario it has a fatal flaw. Once the buyer makes known the cap amount, the buyer has given away the maximum price at which they are willing to buy. If the seller has not received an offer as high as the maximum set by the escalation clause, the seller, armed with this information, can then simply counter at that maximum price or use it as leverage to get more from other prospective purchasers.

Either way there is a problem for buyers. Without the cap, they risk being bound to an outrageously high price. But with the cap, they've given away critical information to the seller about how much they are willing to pay.

Should there be a floor price establishing the minimum amount the buyer is offering to pay? For example, should the buyer offer "XXXX dollars or \$1,000 higher than any other offer received, whichever is greater"?

There are pros and cons to such a provision. On the plus side, in the event there is no competing offer, then the buyer's offer, if accepted, would still create a binding contract. Thus, by including a floor price the buyer adds certainty to the offer that is the equivalent of an offer without an escalation clause. On the other hand, if no other offer matched the buyer's floor price, the buyer will wind up paying more than if the buyer had only included an escalation clause.

Should the buyer include a provision that allows for verification of the next highest competing offer?

Yes. Since the buyer is making an offer dependent upon the offers of other buyers, it makes sense that the buyer should be able to verify that those other offers were in fact bona fide offers. The buyer may include language such as: "Seller shall, upon acceptance, provide buyer with a copy of the highest offer received. Buyer has a right to contact that prospective purchaser making that offer, or his or her agent, to verify the validity of that offer and that the other offer is in fact a bona fide offer."

Should the buyer be cautioned against making an offer with an escalation clause?

Yes. Given that the enforceability of such a contract is not 100% assured, and given the potential pitfalls as discussed in the previous questions, the buyer should be advised to speak with their own legal counsel prior to making such an offer.