

Worth the wait?

Ruth Atkins asks whether exclusivity agreements are worth the effort, or whether they simply serve as a distraction from negotiating the main transaction



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'A lockout agreement does not oblige either party to complete the sale (or letting)... there is nothing to prevent the seller from simply 'sitting out' the agreement and then dealing with a third party once it has expired.'

The process associated with buying or taking lease of a property can be expensive and time consuming, and a seller may withdraw at any time prior to exchange of contracts with limited or no financial consequences. Some buyers and tenants look for a means of protecting their position during the due diligence period in order to lessen the chances of being gazumped and to provide some comfort that their abortive costs will be covered if the seller withdraws. This issue is particularly relevant in a vibrant market, with many bidders competing for a limited pool of prime assets.

The answer, in some cases, is an exclusivity or 'lockout' agreement entered into between buyer and seller (or landlord and tenant), under which both parties agree to a fixed period of exclusivity in return for certain promises on both sides. Such an agreement often requires the seller to refrain from marketing the property during the exclusivity period, and generally prevents it from doing anything that might hinder or frustrate the buyer's progress.

Lockout, not lock-in

A lockout agreement does not oblige either party to complete the sale (or letting). Neither side can be forced to proceed with the transaction, and there is nothing to prevent the seller from simply 'sitting out' the agreement and then dealing with a third party once it has expired. However, a well-drafted agreement is likely to render the property 'off limits' for a certain period, allowing the buyer a reasonable time in which to pursue enquiries, organise surveys and obtain valuation advice, and give comfort

that the time and money incurred in carrying out such preliminary investigations will not be wasted. The objective, from the buyer's perspective, will be to gain a sufficiently strong advantage such that it is best placed to proceed with the transaction on, or before, the expiry of the lockout period.

What to include

A typical lockout agreement will effectively establish a *cordon sanitaire* around the property and negotiations, and may include the following provisions:

- the seller will agree immediately to terminate existing discussions with third parties;
- the seller will not be permitted to negotiate or enter into any transactions with third parties during the lockout period; and
- the seller will agree not to provide any information about the property or business for sale to any other prospective buyer.

The agreement may also set out defined timescales by which the buyer should provide comments on the documentation, commission searches or surveys, or apply for finance, and give the seller rights to terminate the agreement early if the timetable is not adhered to. Similarly, the seller should be placed under an obligation to deal expeditiously with pre-contract enquiries.

Inevitably, the two parties' commercial interests will be at odds with one another. The buyer will want the wording to be as broad as possible to prevent the seller thwarting the

terms of the agreement or the purpose behind it. Any restrictions should therefore be drafted widely so as to encompass any related transactions (even if structured in a different way), so that the seller cannot simply circumvent the exclusivity. Any obligations on the part of the seller should also be expressed to extend to its employees, agents and representatives, to prevent the seller from exploiting this potential loophole.

The seller, on the other hand, will prefer to commit to very specific restrictions and will want the exclusivity period to be as short as possible (particularly in a volatile market), as it will be prevented during that time from taking advantage of

Legal formalities

The concept of lockout agreements was tested and upheld unanimously in the House of Lords decision of *Walford v Miles* [1992] 1 EGLR 207. The case established certain formalities that an agreement must comply with in order to be enforceable:

- The agreement must be supported by *consideration*: case law has shown that the concept of consideration will be interpreted liberally, and may consist of non-monetary obligations (the buyer incurring costs and spending time on due diligence will generally be sufficient). Alternatively, the agreement could require the buyer to make a payment (even a nominal

and effort spent negotiating the additional drafting may make it unsuitable.

- It must consist of, in essence, *negative covenants*: in contrast to some European jurisdictions, English case law shows that positive obligations are unlikely to be upheld. An agreement to act in good faith, while encouraging ethical behaviour, will not be enforceable.
- The agreement must be stated to last for a *fixed period of time*: defining this period as a ‘reasonable time’ will be void for uncertainty, and, in practice, it is usually expressed as a certain number of days or weeks from receipt of a clearly defined and comprehensive package of pre-contract papers (copy title documents, replies to commercial property standard enquiries (CPSE) and a draft contract, for example). This also acts as a spur to the seller’s solicitor to compile the sales pack promptly.

Although clearly preferable in the interests of certainty, lockout agreements are not agreements to sell an interest in land, and are not therefore caught by the requirements of s2 of the Law of Property (Miscellaneous Provisions) Act 1989.

As such, they do not strictly need to be in writing. This may allow disgruntled buyers who have been gazumped to make a claim where oral assurances of exclusivity have been given, but, in reality, the evidential difficulties would make such a claim very difficult to prove.

It is always in both parties' interests for the document to be clear, so as to avoid disputes as to the extent of the parties' duties to one another.

any higher offers. Further, it will want to ensure that the buyer is required genuinely to progress the transaction, given that the property is effectively ‘sterilised’ for the duration of the agreement. For this reason, it should ensure that there are no limitations on its ordinary course of business. If, for example, it is aware that it will want to grant occupational leases or deal with any existing tenants, the agreement should reflect this.

Either way, it is always in both parties’ interests for the document to be clear, so as to avoid disputes as to the extent of the parties’ duties to one another.

sum). If there is ultimately any real concern, the agreement could be executed as a deed to put the issue beyond question, although this might be thought too heavy-handed an approach given the nature of the agreement (and, in fact, the logistics of getting the document executed as a deed may, for some parties, render this an impractical solution and negate any real benefit).

In a very strong market, a seller may be able to demand a non-returnable payment for exclusivity, but its obligations are likely to be correspondingly increased. In addition, the time

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Enforcement and remedies

On the basis that a valid lockout agreement has been found to exist and a claim is made, what redress is available to an aggrieved party? As the buyer could not, by virtue of a lockout agreement, have forced the seller to sell the property in the first place, it will be highly unusual for an injunction to be granted by the courts under their discretionary powers following any breach. Sadly for the buyer therefore, although the most effective remedy from its point of view, an order to require the property to be transferred would be inappropriate. In fact, given that it is so unlikely that an injunction is granted, a very high offer for the property received during the lockout period could be, in the opinion of the seller, worth breaching the agreement for.

A claim in damages is therefore more common and as much as the buyer can reasonably expect. Damages will not be based on the loss resulting from a failure to conclude a legally binding agreement or resulting from the seller's failure to sell to the buyer (ie loss of potential profit), because there can be no way of knowing whether the negotiations would have been successful or what terms would have been agreed had the process continued. The likely measure will, in fact, simply be a sum equal to the buyer's actual wasted costs (eg professional and search fees).

For this reason, the parties may agree to improve the damages position in the buyer's favour by the inclusion of 'liquidated damages' provisions, ie a certain fixed sum to be paid by the seller to the buyer if the agreement is breached, that goes beyond costs actually incurred to third parties (for example, to cover management time and overhead expenses). If incorporated, the parties should take care to ensure that any such provisions are carefully worded, are a genuine pre-estimate of the buyer's loss and not so onerous as to be deemed a penalty on the paying party, as this in itself will lead to questions of enforceability.

Either way, a buyer may be disappointed by the likely remedy of damages for wasted expenses, if in fact it simply wishes to proceed with the purchase.

Key points

- Lockout agreements are sometimes used at the outset of a property transaction and are intended to prevent the seller from dealing with third parties during a fixed period. They can also be used to restrict the buyer (or tenant) from progressing discussions on other properties during that period, although this is far less common.
- There is no guarantee that exchange of contracts will follow an exchange of a lockout agreement. The intention is to give the buyer time to carry out initial investigations and to organise finance, not to oblige the seller to complete the sale.
- If the lockout agreement is breached, the buyer's remedies are usually confined to wasted costs only.
- Lockout agreements often take longer than expected to negotiate and can distract the parties from making progress on the intended transaction. The benefits of exclusivity should therefore always be weighed up against the additional time spent in agreeing the document.

Are there any other options?

It is a common misconception amongst buyers that, by entering into a lockout agreement, a seller is somehow committing to selling the property. If a buyer is looking for longer-term protection, and is willing to spend further time and money on negotiation, it could consider entering into an option agreement (or 'call option'). This potentially allows the buyer to 'trigger' a purchase at its discretion, and secure the property from competitors for the duration of the option period. A developer with the benefit of a call option could, for example, apply for planning permission for the relevant property, knowing that it has the right to buy the property if successful, but no obligation to do so if consent is not forthcoming.

Alternatively, a buyer concerned that it does not have the influence or financial clout to secure an exclusivity agreement may obtain some limited comfort from the solicitors' professional conduct rules. These require sellers' solicitors to notify any party in receipt of papers that the seller intends to deal with a second prospective buyer (or to stop acting in connection with the transaction if their client refuses to allow them to do so (the so-called 'contract race' rules)). This process at least serves to identify competing parties, albeit that the notification may arrive too late to allow the first buyer to take action.

Summary

Whether or not exclusivity is agreed in relation to a particular transaction will depend on the strength of the buyer's negotiating position. Where

agreed and documented, lockout agreements may provide buyers with additional confidence to proceed with a transaction and to incur the costs associated with their property due diligence. They may also allow potential buyers to gain significant advantages over their rivals during the exclusivity period, the intention being that they are perfectly placed to proceed with the transaction at the end of that period. An opportunity to limit exposure to the risk of being gazumped becomes particularly important where the market for prime investment sites is increasingly competitive. Lockout agreements do not, however, compel the seller to negotiate and to sell the property to the buyer during the exclusivity period.

Given the conflicting stances taken by either party, it will come as no surprise to learn that such agreements often take far too long to negotiate, and rather than focusing the parties' minds during the critical negotiation phase, can actually be counterproductive and distract the buyer and seller from making progress on the transaction at hand. For this reason, the inclusion in an exclusivity agreement with controversial terms that are likely to trigger in-depth negotiation should be avoided. In all cases, the potential benefits of exclusivity should be weighed up at the outset against the additional time that is likely to be spent in negotiating and agreeing the extra document, to ensure that it has practical value. ■

Walford v Miles
[1992] 1 EGLR 207