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### TRANSACTIONAL REAL ESTATE

# Specific Performance of a Sale-Leaseback



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Specific performance is an important remedy in real estate transactions, and is typically specified when drafting agreements for the purchase and sale of real estate; in the event that the seller breaches its obligation to sell the property, the buyer can seek court intervention compelling the seller to follow through with the sale. However, a specific performance remedy is disfavored by the courts, and under certain circumstances (particularly in the case of sale-leasebacks), a specific performance clause, even if properly drafted, may not be enforced by the courts.

### Specific Performance Generally

Specific performance is an equitable remedy for a breach of contract, in which a court will force the breaching party to perform its contractual obligations. Although courts generally prefer awarding monetary damages to the non-breaching party, they do have discretion to award specific performance.

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However, the remedy of specific performance is typically disfavored and is reserved for transactions involving items that are unique. Courts will often take the view that parcels of real property are unique and that, where a seller breaches its obligation to sell real property, the buyer will not be made whole by an award of money damages. Courts are, therefore, more willing to specifically enforce agreements pertaining to the sale of real property.

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### Sale-Leasebacks Generally

Sale-leaseback transactions are a staple of real estate finance that have become even more prevalent in recent years. As the name would suggest and as defined in a respected treatise, a

sale-leaseback consists of “a sale by the owner of the property, followed by the execution of a lease from the purchaser, as landlord, back to the seller, as tenant.” 2 Richard R. Powell Et Al., Powell On Real Property § 17A, at 17A-2 to 17A-3 (Michael Allan Wolf ed., 2000).

Leases entered into in connection with such transactions typically have a lengthy term, and are on a so-called “triple net” basis under which the tenant assumes responsibility for all taxes, insurance, maintenance, and other costs of carrying the property. Upon executing a sale-leaseback, the tenant’s position as to use, occupancy, and responsibility for operating expenses does not differ, in practice, from the position that the tenant enjoyed as owner prior to sale.

A sale-leaseback transaction serves different functions: It permits the seller to raise capital on terms that may be more attractive to the seller than mortgage or other financing, and permits the purchaser to invest capital in a manner that generally offers a fixed but increasing return over time and relatively low risk with the ability to capitalize on any appreciation in the

property value over the term. It is also a means of securing tax advantages to both parties by giving the former owner (now tenant) a rental deduction and giving the purchaser (now owner and landlord) deductions for depreciation, and interest if the purchase price is financed.

### Specific Performance for Sale-Leasebacks

The integrated nature of a sale-leaseback raises issues in the event that either party attempts to specifically enforce a sale-leaseback agreement. Imagine that Party A agrees to sell its headquarters to Party B and subsequently lease back the premises for 20 years, and that after signing the contract and before closing Party A has a change of heart. Can Party B compel Party A to not only complete the sale but also enter into the lease? Essentially, would a court be willing to compel Party A into a sale along with a subsequent leaseback. If not, would the court be willing to bifurcate the sale and leaseback and perhaps enforce the sale but not the leaseback? Even if a court were to order the sale, query whether either party would even be satisfied with such a result.

The leaseback is an integral piece of the buyer's investment strategy, and the leasehold position may be critical to a seller's business operations; removing that part of the puzzle may well frustrate the intent of the parties.

Specific performance is available as a remedy for breach of an agreement to enter into a lease. In jurisdictions across the country, courts have held that a written executory contract to enter into (or renew) a lease may be

specifically enforced, provided that it conforms to the general rules governing the specific performance of contracts (such as the requirements that the contract be fair and reasonable, mutual, and certain in all its parts).

Particularly in New York, however, it is generally disfavored as a first option. *Van Wagner Advert. Corp. v. S & M Enterprises*, 67 N.Y.2d 186, 192, 492 N.E.2d 756, 759 (1986). Where a party breaches its obligation to enter into a lease, New York courts "do not grant specific performance...as a matter of course, as they do in the case of agreements to buy or sell land." *Schwartz v. Church & Commerce Corp.*, 184 Misc.2d 200, 53 N.Y.S.2d 666 (Sup. Ct. 1945); 173 A.L.R. 1161 (originally published in 1948) (citing *Schwartz*, 184 Misc. at 202).

In the absence of special circumstances, courts will not grant the equitable remedy of specific performance in this context, unless the aggrieved party can demonstrate the inadequacy of legal remedies, which is considered a prerequisite. *Koenig v. Eagle Waist Co., Inc.*, 176 A.D. 726, 728, 163 N.Y.S. 1019, 1020 (App. Div. 1917).

Any sale-leaseback involves an ongoing relationship between the parties, and any suit for specific performance seeks to compel a party to take an action that it has resisted taking. For these reasons, and based on a perceived animosity between the parties, the court in at least one case ruled that specific performance was unavailable to the buyer in a sale-leaseback transaction.

In a New Jersey case, *LLB Realty, L.L.C. v. Core Laboratories, LP*, 123 F. App'x. 490 (2005), neither the federal

district court, nor the U.S. Court of Appeals for the Third Circuit, on appeal, would grant specific performance with respect to a sale-leaseback, or even the sale without the leaseback component. LLB Realty and Core Laboratories negotiated and signed an offer to purchase agreement, pursuant to which Core agreed to sell real property to LLB and lease it back for a ten-year term.

The agreement contemplated that the parties would enter into a final purchase and sale agreement within 60 days. Six months later, Core formally informed LLB that for business reasons it no longer wished to proceed with the transaction. LLB filed suit requesting specific performance and filed a *lis pendens* on the property. The district court dismissed the suit and vacated the *lis pendens*. LLB appealed to the Third Circuit.

The Third Circuit, quoting *Dover Shopping Ctr., Inc.*, held that specific performance was not available as a remedy. The court noted that granting specific performance would "have forced hostile parties into a lengthy and antagonistic lease agreement that would have been viewed as oppressive and required long-term supervision," and commended the district court for "wisely refus[ing] to do so."

The court further noted that enforcing the sale without the accompanying leaseback was inequitable. Because the leaseback was a key factor in the determination of the sale price, specific performance of the contract without the leaseback would have required a re-determination of the sale price. This, the court said, would have required the court "to negotiate a different real

estate transaction for the parties rather than enforce the one they agreed upon.”

The court in *LLB Realty* did not want to entangle itself in an already acrimonious relationship. The court observed that the parties clearly disliked each other, and the court did not wish to force the parties – against the seller’s wishes – into a long-term relationship which the court would inevitably need to referee.

Further, because the stated sales price was heavily dependent on the leaseback (which the court would not compel), the court also declined to grant specific performance as to the sale. Given such concerns about decoupling sales and leasebacks in a transaction and New York courts’ general hesitancy in granting specific performance for agreements to enter into a lease, one cannot assume that a New York court would order specific performance of either component of a sale-leaseback.

### Other Contexts

In addition to sale-leasebacks, there are various contexts in which buyers and sellers of real property agree to maintain ongoing relationships post-closing or to undertake actions ancillary to the sale. For instance, a seller may provide financing for the purchase of the property. The buyer may wish to operate the property under a license held by the seller (e.g., an assisted living license).

Prior to closing, the parties may need to coordinate in connection with the buyer’s assumption of existing financing or in obtaining third-party consents. In all the above scenarios, cooperation

between the parties may be necessary to produce a successful (or perhaps even viable) transaction.

In light of courts’ reluctance to require parties to perform certain acts, it is not entirely clear that courts would order specific performance in the context of the arrangements described above. For example, courts in other states have expressed reservations about specifically enforcing agreements that require one of the parties to obtain consents or approvals of third parties. *Casady v. Modern Metal Spinning & Mfg. Co.*, 188 Cal. App. 729, 731 (1961); *see also W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC*, No. 2742-VCN, 2007 Del. Ch. LEXIS 154, at \*57 (Del. Ch. Nov. 2, 2007).

In the context of seller financing, however, New York courts have granted specific performance. In *Bregman v. Meehan*, 125 Misc. 2d 332, 479 N.Y.S.2d 422 (Sup. Ct. 1984), a young couple entered into a contract to purchase a home with partial financing from the seller in the form of a purchase-money mortgage loan at the then prevailing rate. The seller subsequently refused to sell her home or extend financing, the couple sued, and rates rose 75 basis points by the time of trial. The court ordered specific performance of not only the sale but also the financing.

The court reasoned that, although courts of equity will not ordinarily decree specific performance of a commitment to lend money, a purchase-money mortgage loan is “an integral part of a contract to sell real property” and can therefore be compelled in a suit for specific performance of the sale.

More recent cases have echoed this logic and granted specific performance

with respect to seller financing. *BT Triple Crown Merger Co., Inc. v. Citigroup Glob. Mkts., Inc.*, 19 Misc. 3d 1129(A), 866 N.Y.S.2d 90, 90 (Sup. Ct. 2008).

### Conclusion

Parties who seek to preserve the option of obtaining specific performance would be well-served to draft their agreements and structure their transactions so as to minimize the grounds on which a court may decline to grant it—by, for example, fully negotiating any lease agreement, and requiring that necessary third-party consents be procured, prior to signing the contract. Even then, based on the reservations expressed by courts in the case of sale-leasebacks and in other contexts, parties to these transactions should understand that specific performance may be subject to certain limitations.

Even where the parties include a specific performance clause in their contract, a court may decline to exercise its equitable powers to force a seller to take actions needed to achieve the outcome for which the buyer bargained.