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Requiring Sellers to Attempt to Mitigate Damages on Property Buyers' Default

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On March 21, 2013, in *White v. Farrell*[1] the New York Court of Appeals declared for the first time the measure of damages to be applied in a real property seller's action against a breaching buyer. *White's* principal holding adopted, albeit with clarification, the "date-of-breach" rule long applied in the Appellate Divisions. *White* may prove more significant for its secondary if not tertiary holding that a seller suing for damages exceeding a retained down payment must seek to mitigate its damages by attempting to resell the property at a reasonable price.

It remains to be seen whether courts applying *White's* mitigation holding will treat a seller's failure to make sufficient resale efforts as grounds for denying damages that might have been recouped through resale, or as only a factor going to the weight given to a resale price offered as probative of date-of-breach damages. In either case, mitigation must now be considered not only by litigators presented with a fully framed real estate contract claim but by counsel when drafting contracts of sale and when advising parties after a breach. This article reviews *White* with emphasis on issues presented by its mitigation holding, and suggests approaches sellers' counsel might consider when seeking to avoid handing a breaching buyer a "failure to mitigate" defense.

'Date-of-Breach' Measure

Before we consider the mitigation holding, *White's* primary holdings announcing the "date-of-breach" measure of damages warrant discussion. All of *White's* holdings are of concern principally to parties whose contracts of sale lack liquidated damages provisions. A contract providing merely that a seller may retain a defaulting buyer's down payment, without more, does not liquidate damages. Even without such a provision, a defaulting buyer generally may not recover the down payment, at least where the amount is not disproportionately large compared with the seller's potential actual damages (see, *Maxton Builders v. LoGalbo*[2]).

Absent liquidated damages, a buyer's breach allows the seller to sue for such additional sum, if any, by which its actual damages exceed the retained down payment. The risk of such damages is not merely theoretical, especially where parties agree to less than what the *Maxton* court called a "traditional" 10 percent down payment, and allow for an extended period between contract and closing, during which time markets may soften.

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The transaction in *White* involved a Skaneateles property with a $1.725 million contract price and a $25,000 down payment. At less than 1.5 percent of the contract price, the down payment was modest by "traditional" standards.[3] When the transaction collapsed and the buyers sued to recover their $25,000, the sellers counterclaimed for actual and consequential damages. The property was resold for $1,376,500 during the pendency of the action, some 14 months after the repudiation.

On the parties' motions for summary judgment, the motion court rejected the sellers' argument that their actual damages were the difference between the contract price and the resale price. It applied the date-of-breach measure and found no difference between contract and market price as of the breach date. The sellers appealed only the decision on actual damages, leaving unreviewed the additional rejection of their consequential damages claim. The Appellate Division, Fourth Department, affirmed without discussion, and the Court of Appeals granted leave to appeal.

White's principal holding adopted the rule of the Appellate Divisions that the measure of damages is the difference between the contract price and the fair market value of the property at the time of the buyer's breach. *White* also clarified the relevance of a subsequent resale, holding that resale price is probative (not dispositive) of value as of the date of breach. The case was remitted for a damages hearing.

Duty to Mitigate

The duty to mitigate is described as an "active duty" owed by the injured party seeking damages to make "reasonable exertions to render the injury as light as possible."[4] Failure to mitigate is an affirmative defense,[5] and the defendant bears the burden of proving the plaintiff's lack of diligent efforts to mitigate, and the extent to which such efforts would have diminished plaintiff's damages.[6]

White's first mention of mitigation appears in its comment that the date-of-breach damages rule "is consistent with the general contract principles that damages 'are properly ascertained as of the date of the breach,' and 'the injured party has a duty to mitigate' (see *Brushton-Moira Cent. School Dist. v. Thomas Assoc.* 91 NY2d 256, 262-263 [1998] [measuring damages for breach of a construction contract from the date of the breach rather than from the date of the damages trial held 13 years later])." *Brushton-Moira* involved faulty windows,

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not a breached real estate contract.

That initial reference might, in isolation, fairly be understood as only a rationale for adopting the date-of-breach measure. Indeed, the court's language echoes the observation that "the result under the general rule [i.e., the date-of-breach rule] would appear to be consistent with the mitigation of damages doctrine."[7] However, the court made it clear that its reference to mitigation was indeed a holding when its specification of issues to be determined at the damages inquest upon remittitur included "whether the [sellers] made sufficient efforts to mitigate (i.e., to resell at a reasonable price after the [buyers'] default), which is relevant to any weight to be given the resale price as a measure of fair market value at the time of the breach…."

The concurring opinion urged that a measure of damages different from the date-of-breach measure adopted by the majority was warranted. In that context, the two concurring judges referred to the majority's discussion of mitigation as a holding, and opined that mitigation is irrelevant if sellers' damages are determined by fair market value at the time of breach.

Challenges for Sellers

White's mitigation holding presents challenges for sellers, especially in the prelitigation stage following buyers' breaches. Perhaps the most dramatic effect will be felt by sellers deciding whether to keep their properties or put them back on the market. If the mitigation duty is to be applied in real property contract litigation as in other contexts, choosing to keep the property may be at the peril of affording the repudiating buyer a "failure to mitigate" defense that could let it off the hook for damages exceeding the down payment.

On the other hand, if what *White* termed "mitigation" is to be understood and applied only as an analytical framework to determine the weight given to a resale price if, as in *White*, a resale occurs and is offered as evidence of value, retention of the property and the absence of attempts to resell ought not prejudice the claim. Under such view, the damages trial could proceed notwithstanding the lack of an attempted resale, with value determined by a battle of experts and date-of-breach appraisals.

If there were a resale, and the resale price were proffered as probative of value, then the quality of the "mitigation" efforts to maximize the price would be relevant. Support for this interpretation is found in the coda to *White's* mitigation holding, which explains that the quality of the seller's attempts to resell at a reasonable price "is relevant to any weight to be given the resale price as a measure of fair market value at the time of the breach."

Unless and until the "evidentiary weight" interpretation may prevail over the "substantive duty" interpretation in applying *White's* mitigation holding, a seller inclined to keep the property off the market post-breach (e.g., to await market recovery or to receive the cash flow from rentals) will need to balance the benefit of so doing against the potential for impairing its damages claim.

Under either interpretation, a seller's renewed efforts to sell will have dual significance. Marketing efforts normally shaped solely by business considerations become integral components of the prelitigation record when damages are being pursued. *White* presents no bright-line standards for determining whether a seller's mitigation duty has been met but does instruct that courts must ascertain whether the seller made "sufficient efforts to mitigate," i.e., "to resell at a reasonable price" after the breach. The terms "sufficient" and "reasonable" signal that resale efforts need not be exhaustive or rise to a "best efforts" level in order to discharge the duty. This is in keeping with the general principle that the duty of mitigation calls for reasonable efforts to avoid consequences of the complained-of act. What efforts will be found "sufficient" and what resale asking price will be found "reasonable" will depend of course on the nature of the property and market involved.

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Given that the date of breach marks not only the damages valuation date but the commencement of the prelitigation phase, sellers should be mindful of how their renewed marketing efforts will be viewed by the trier of fact. Conveniently, the efforts most likely to avoid a defense of failure to mitigate should differ little from those most likely to achieve the best resale for the seller. Marketing that seeks to maximize both the price and speed of resale, even if unsuccessful in one or both aspects, would provide the best immunization from a mitigation defense.

Conversely, perfunctorily dumping a property for the first low-ball offer, or refusing for a protracted period to accept good-faith market-based offers while holding out for an unjustifiable price, will invite a defense that reasonable efforts to avoid damages were not made. Valiant attempts to resell will have no litigation value without admissible proof establishing them. This entails a heightened level of oversight and record-keeping, especially when marketing is delegated to brokers unaccustomed to thinking in terms of "mitigation."

An additional wrinkle is that ability to resell may be thwarted by a notice of pendency. Buyers disputing declarations of default frequently assert claims or counterclaims for specific performance (a classic basis for filing a lis pendens) or for return of the down payment. While the latter, being for money only, does not justify filing a lis, savvy attorneys might join a claim to foreclose the buyer's lien, which does support a lis. Logically, filing a lis should excuse a seller from mitigating, but the question appears unadjudicated.

Conclusion

It is noted that nothing in *White* suggests that mitigation is required for retention of a breaching buyer's down payment. Nor did *White* appear to abrogate the rule that a seller's right to retain the down payment is unaffected by a later sale at a price the same or greater than that in the original contract.[8]

Until the jurisprudence of mitigation in real property law is developed more fully, it may be prudent to consider anticipating and addressing the attendant issues with provisions of contracts of sale specifying what duty of mitigation, if any, will apply, and whether and if so how a resale will affect a damages claim. Alternatively, liquidation of damages, where appropriate, may avoid the mitigation and other damages issues addressed in *White*.

1. —N.Y.3d—, 2013 N.Y. LEXIS 469, 2013 NY Slip Op 1870 (March 21, 2013).
2. 68 N.Y.2d 373 (1986).
3. "Standard" down payment amounts vary widely among markets. Appellants' counsel in White, John A. Cirando, said in a conversation with the author that the $25,000 down payment in that case was considered substantial in the Onondaga County market for residential property.
4. *Wilmot v. State of New York*, 32 N.Y.2d 164, 168 (1973), quoting *People's Gas & Elec. v. State of New York* , 189 App.Div. 421, 424, quoting *Hamilton v. McPherson*, 28 N.Y. 72, 77.
5. See, *Ahistrom Machinery v. Associated Airfreight*, 251 A.D.2d 852 (3d Dept. 1998).
6. *Cornell v. T.V. Dev.*, 17 N.Y.2d 69, 74 (1966).
7. "Seller's Damages From a Defaulting Buyer of Realty: The Influence of the Uniform Land Transactions Act on the Courts," Gerald Korngold, 20 Nova Law Review 1069, 1077 (1996), citing Restatement (Second) of Contracts, §350 (1979).
8. *Johnson v. Werner*, 63 A.D.2d 422 (1st Dept. 1978).