

Scrivener Beware in Real Estate Contracts

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If you write up a real estate contract that is too good to be true, a court might find it to be too good to be true, and deny you the ability to enforce your contract.

In the recent case of Steiner v. Thexton decided May 29, 2008, a savvy buyer developer made what seemed like an excellent real estate contract. The buyer needed to conduct due diligence on purchasing a 12.29 acre parcel and effecting a desired subdivision. The contract stated in pertinent part: "Upon successful completion of subdividing the 10 acres from the existing parcel, Buyer will pay the Seller the balance of the purchase price to escrow and close immediately." The contract also provided: "It is expressly understood that the Buyer may, at its absolute and sole discretion during this [escrow] period, elect not to continue the transaction and the purchase contract will become null and void." What a deal!

The buyer sued for specific performance following the seller's repudiation of the contract. The trial court found the contract to be an unenforceable because it was a disguised option contract, lacking "consideration." Consideration is the legal requirement that there be a quid pro quo bargained exchange. The Court of Appeal affirmed the trial court, holding that the "agreement was an (attempted) option in which defendant bound himself to sell on specified terms and left it discretionary whether Steiner [the buyer] would or would not buy the property." The contract was nothing more than a continuing offer to sell which could be revoked at anytime.

There is little remarkable about this decision except that it should remind the sophisticated purchaser that if he makes a deal so one-sided, the contract may be found to be illusory. The buyer could have avoided the adverse court ruling by simply paying a non-returnable amount for the option -- whether \$5,000, \$500 or \$5 -- as consideration.

Similarly, an eager seller may wish to insert a "no-contingency" contract term to make a buyer really commit to buy and to punish the buyer if he fails to close. Watch out, such contracts may likewise be held invalid.

In Realmuto v. Gagnard, the seller failed to provide a transfer disclosure statement under California Civil Code section 1102 to a would-be buyer, but nonetheless sought to sue the buyer for breach of contract. The Court held that the provisions of Civil Code section 1102 for residential buildings under four units cannot be waived by contract. Any waiver "is void as against public policy." The Court barred the seller from any recovery against the buyer for breach of contract where the seller had never provided the required statutory disclosure, which obligation could not be waived.

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Penalty clauses are not normally enforceable. A liquidated damages provision in a contract for the sale of real property is invalid unless the contractual provision is separately signed or initialed by each party to the contract and is in either ten-point bold type or eight-point red type as California Civil Code sections 1677 and 1678 require. A provision which does not satisfy these requirements cannot be enforced by the seller, but it is not void and can be relied on and enforced by the buyer as a limitation on liability.

Guthman v. Moss illustrates this point. There, an amendment to the escrow instructions for a residential property included a liquidated damages clause limiting damages to \$24,000 even though the buyer deposited \$25,000 into escrow. The buyer failed to close escrow. The seller argued that since the liquidated damages clause was not signed or initialed by the parties, it was invalid. The court concluded that the legislative intent of a liquidated damages clause is to protect the buyer and that Section 1677 gives the buyer the option of either enforcing the clause or voiding it when the statutory formalities are not satisfied.

The bottom line is that you cannot make a deal that violates common law or statutory strictures. A court may find that your tough contract cannot be enforced.