

## SUPREME COURT REVERSES DECISION THAT THREATENED TO UNDERMINE THE ENFORCEABILITY OF REAL ESTATE PURCHASE AGREEMENTS

On March 18, 2010, the California Supreme Court unanimously reversed the decision of the lower court in *Steiner v. Thexton*, a controversial opinion issued in 2008 that held that a buyer could not enforce a purchase agreement because it was not supported by consideration. [The lower court had ruled](#) that the purchase agreement was actually a *revocable* option that lacked binding consideration because the buyer reserved a right to terminate the contract in its sole and absolute discretion and recover its entire deposit at any time, and the buyer was not obligated to do anything that, in the opinion of the lower court, constituted a benefit to the seller or a detriment to the buyer. As a matter of general practice, purchase agreements include provisions permitting a buyer to terminate in connection with due diligence, entitlement, environmental or other contingencies without forfeiting any funds to the seller. As such, the lower court's decision, had it been affirmed, arguably would have jeopardized the enforceability of the overwhelming majority of typical real property purchase agreements.

The California Supreme Court's reversal rested on a two-pronged analysis of the lower court's reasoning: first, whether the agreement in question was an option, or a unilateral agreement, rather than a mutually binding, bilateral contract; and second, whether the option was revocable by the seller/optionor due to lack of consideration. In reversing the lower court's decision, the Court held that while the contract in question was an option, it was supported by sufficient consideration and therefore irrevocable. The buyer could therefore enforce the agreement against the seller.

### ***Does the Reversal in Steiner Confirm the Enforceability of Real Estate Purchase and Sale Contracts?***

Both prongs of the analysis are relevant to whether purchase and sale agreements generally used in the real estate industry, which include rights of buyers to terminate unilaterally, are enforceable. The Court distinguished the agreement in *Steiner*, which allowed the buyer to terminate at any time for any reason, from the "common form of real estate contract" pursuant to which "withdrawal from such a contract is permitted *only* if the contingency fails." The Court summarily concluded that "bilateral contracts subject to a contingency, which are widely used in real estate transactions, are not affected by our holding."

The Court is essentially indicating that under customary real estate contracts, the buyer's obligation to buy is not illusory since the obligation is subject only to the failure of specified contingencies. However, it is unclear whether including certain types of contingencies may result in a contract being deemed an option revocable by the seller. While the Court acknowledged that inspection contingencies are generally not problematic, it is uncertain whether, for example, a buyer's right to terminate *in its sole and absolute discretion* during a feasibility review period could render the contract illusory and therefore an option revocable by the seller. What if the contract states, as buyers often prefer, that the buyer can terminate *for any reason or no reason* during the feasibility period?

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With respect to consideration, the Court concluded that, even though the contract lacked consideration at the time it was entered into, the buyer created sufficient consideration to render the option irrevocable by its partial performance of the promise to pursue a parcel split of the property, a “bargained-for” benefit to the seller. In short, a buyer can subsequently “make up” for the initially illusory nature of its obligations under the contract if such subsequent consideration was bargained for by the parties when they entered into the contract. As such, to the extent that no other consideration, such as a non-refundable deposit or a firm obligation to purchase exists, buyers will want to ensure that any detriment incurred or benefit conferred be explicitly bargained for under the purchase contract.

The Court raised the possibility, rejected by the lower court, that posting a deposit may constitute sufficient consideration, even if it is refundable. The Court indicated that giving up the use of funds deposited in escrow arguably constitutes a prejudice to a buyer, even if the buyer ultimately gets the money back. If other courts determine that posting a refundable deposit constitutes sufficient consideration, the lingering questions of enforceability of “standard” purchase and sale contracts not addressed in the *Steiner* decision could be resolved.

Of course, all judicial determinations are fact specific, as are the contracts being interpreted thereunder. In drafting purchase contracts, buyers should take precautions to create the best possible case for enforceability under the particular terms of their deals.

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