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Entitlement Contingency in Purchase Contract Ruled to Be Unenforceable Option

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In May 2008 the California Court of Appeal issued a decision with potentially draconian consequences in *Steiner v. Thexton*, 2008 WL 2191300 (Cal. App. 3d Dist.). The Court of Appeal held that a real estate purchase contract containing a contingency allowing the buyer the absolute and sole discretion to terminate the contract if the buyer were unable to obtain entitlements for the development of the subject property was "really an attempt to create an option agreement," which failed for lack of consideration. When Thexton, the seller, informed Steiner, the buyer, that he no longer wanted to sell the property, Steiner had already made a $1,000 deposit into escrow and completed 75%- 90% of the work needed for his desired entitlements. Nonetheless, the Court of Appeal ruled that Thexton had the right to terminate the contract unilaterally because, as "an option not supported by any consideration," it was unenforceable against the Seller. As to the $1,000 deposit in escrow, the Court of Appeal found that it did not constitute consideration because it was applicable against the purchase price if Steiner elected to proceed with the purchase. Since the attempt to create an option failed due to lack of consideration, the "contract" was, according to the Court of Appeal, "nothing more than a continuing offer to sell that could be revoked by Thexton at any time."

In *Steiner* the buyer was a real estate developer who wanted to develop several houses on a 10-acre portion of the seller's 12.29-acre property. Pursuant to the terms of a September 4, 2003 purchase contract ("Contract"), the Seller agreed to sell the 10-acre portion of his property to the Buyer for $500,000 by September 1, 2006, if the Buyer decided to purchase the property after "expeditiously" pursuing county approvals and

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permits. The Contract included a series of contingencies providing that the Buyer would seek the necessary entitlements and permits for his proposed development. Because the Buyer was willing to purchase the property only if he were able to obtain the requisite entitlements, the Contract provisions permitted the Buyer to cancel the Contract at any time before escrow closed. The Contract further provided for automatic termination if the buyer did not obtain the requisite entitlements by September 1, 2006. Upon the opening of escrow, the buyer made a $1,000 deposit "applicable toward [the] purchase price."

In October 2004, after the buyer had allegedly completed 75%- 90% of the work needed for county approval, the seller requested that the title company cancel the escrow. Notwithstanding the Seller's expressed intention not to proceed with the Contract, the Buyer proceeded with the final hearing of the county's parcel review committee and succeeded in obtaining county approval for a tentative map. The Buyer then filed an action for specific performance of the Contract against the Seller.

The Court of Appeal ruled that the Contract was really a "disguised" option, not a purchase agreement; although the seller was bound by the terms of the Contract to sell on specified terms, the buyer had discretion as to whether he would buy the subject property. In affirming the trial court's denial of the buyer's right to specific performance, the Court of Appeal determined that the option was not supported by consideration and that the seller was therefore free to revoke the offer at any time. The buyer argued that there was adequate consideration for the option because (1) the buyer pursued the county approvals at his own expense, (2) the Contract required that, in the event of termination, the Buyer was to turn over to the Seller copies of all information, reports, tests, studies and other documentation obtained by the Buyer from independent experts and consultants concerning the property, and (3) the buyer's promise to act "expeditiously" constituted consideration for the option and a legal obligation under the implied covenant of good faith and fair dealing. The Court rejected each of these arguments, finding that the provisions of the Contract did not impose binding legal obligations on the buyer because he had the choice of terminating the Contract at his discretion, without seeking entitlements, making any expenditures, or "doing anything at all."

The Court of Appeal also rejected the buyer's argument that the seller was estopped from backing out because the entitlement application work was nearly complete. In rejecting

this argument, the Court observed that, because the buyer drafted the agreement to provide a unilateral termination right for himself, there was "no injustice in a resolution of this case that effectively accords the reciprocal right to [the seller]."

Although the ruling in *Steiner* may ultimately rest on the particular facts of the case – i.e., that the promise to act expeditiously was unenforceable since the agreement did not require the buyer to move forward at all and the seller received no benefit from the buyer's acquisition of the entitlements – attorneys, developers and other real estate professionals should view the case with caution when negotiating and drafting real estate purchase and sale agreements. In particular, the decision requires critical analysis of the precise consideration supporting any contingencies the failure of which consideration leads to the unilateral right of the buyer to terminate the agreement.

The buyer has petitioned the California Supreme Court to review the Court of Appeal's decision. For the time being, however, the *Steiner* decision remains binding legal authority.

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