Topic 7: Contracts in Real Estate Transactions

(*Copyright © 2024 Joseph W. Trefzger*)

[In the discussion that follows we must generalize, for reasons that include 1) contracts can contain unusual features, and courts sometimes rule in unexpected ways even when the features do not seem unusual; 2) judges must interpret uncertain wording based on context and strive for objectively fair outcomes, up to the point of at times invalidating otherwise seemingly binding contracts by ruling they contain "unconscionable" terms; and 3) varying legal results can come about both because state laws in the U.S. can differ, and because a contract between a U.S. party and a foreign party could be decided based on U.S. law, the foreign party's national law, or even a third country's laws. And perhaps most importantly, your superannuated instructor is not a lawyer. In our course we tend to look at contracts from an economic standpoint more so than from a pure legal perspective.]

Real estate has value because its ownership entitles the owner to exercise, or perhaps to sell, certain rights. Because rights in real estate are not tangible items, they can be safeguarded only through enforceable contracts and other legal tools, many of which are placed in public records to protect the owner's interest and to defend against the claims that third parties may assert with regard to the property.

A *contract* might be defined as a promise or series of promises, constituting an agreement to exchange something of value, that courts will enforce. An explicit written contract for the purchase/sale of real estate serves the important purpose of keeping the parties bound to their agreement during the period, sometimes lengthy, when complex paper work takes place (as opposed to the immediate completion of a retail purchase – which, itself, involves a contract between the purchaser and the store). Property values might change, for example, and absent a means of enforcement a buyer (seller) might chose not to honor a commitment to buy (sell) without a reduction (increase) in the price. Having an enforceable contract helps reduce risk/assure certainty for all parties to a transaction.

I. We can characterize contracts in various ways:

A. *Unilateral vs. Bilateral* – most contracts are bilateral, with each party acting (or promising to act) in a certain way; *e.g.*, a contract for the sale of real estate, with the seller obligated to sell/deliver a deed and the buyer obligated to buy. Some contracts, though, are unilateral, in which one party promises to act only if a specified provision is fulfilled; *e.g.*, a listing contract (seller agrees to pay a commission if the broker finds a buyer, but the broker can not be forced to perform – maybe it is an unusual property that few would want to buy).

B. *Express vs. Implied* – a contract can be implied by circumstances and actions even if there are no explicitly spoken or written words; for example, someone who sits at a restaurant table and consumes food the servers bring can not then say, "I have no financial obligation, because I never agreed to pay for the meal." (An implied contract can exist only if the recipient of a purported benefit has the opportunity to reject it; a person can not wash your car without your knowledge and then demand payment under an implied contract – though a court might find that an implied contract exists if Party A acts in a manner consistent with A's actions in earlier dealings with Party B.)

C. *Valid vs. Voidable vs. Void vs. Unenforceable* – for a contract to be *valid*, all essential elements must be present. A *voidable c*ontract has one or more elements missing; the wronged party has the choice of enforcing or avoiding (*e.g.*, unapproved dual agency in a real estate sale). A *void* contract is contrary to public policy, so the law does not view it as a contract (courts will not enforce it) even though offer, acceptance, *etc*. are present (*e.g.*, a contract employing someone to burn down a house to collect fire insurance proceeds). A lease on agricultural land that lasts longer than 15 years is void as a matter of law under the Wisconsin state constitution[1] (farm leases running longer than 20 years in Iowa, 21 years in Minnesota, and 51 years in California are void under those states' constitutions).[2]

An *unenforceable* contract contains the elements of a valid contract but will not be enforced by a court for other reasons (*e.g.*, it has ambiguous terms, or a statute of limitations has expired; in Illinois you generally must sue for breach of an oral contract within five years of the alleged breach).

What elements cause a contract to be valid and enforceable? They are *agreement*, *consideration*, parties acting under *free will*, parties who are legally *competent*, and a *legal purpose*. Also, as noted before, contracts involving the sale of real estate generally must be in writing, if they are to be enforceable in court, to comply with the *statute of frauds* – which also requires both sales contracts and deeds to contain written legal descriptions.

1. *Agreement* – also called "mutual assent" or "offer and acceptance."
a. *Offer* – a promise to act in a specified way if the other party will act in some other specified way (also informally defined as an invitation to enter into a contract). An offer must:

i) Not be a joke, not a statement made under duress. More subtly, not an invitation to make an offer (advertising something for sale usually is viewed legally as an invitation for others to make offers, with specific terms).

ii) Be communicated by an *offeror* to a specific party, the *offeree*. You can not deem an action on someone's part to be acceptance of an offer if they do not know an offer has been made; *e.g.*, resort gives someone a free weekend visit but does not tell them that by showing up they have accepted an offer to buy a time share unit. An offer can be made by a potential buyer (offer to buy) or seller (offer to sell).

iii) Have reasonably complete, definite terms. An enforceable offer to purchase or sell real estate must give information as to identities of parties, identity of the property, time of performance, price, how price is to be paid, special steps that must be taken to show acceptance of the offer, any other issues of major importance.

Termination of offer – once an offer is made the offeror is bound by the terms if an offeree accepts it, so you have to be very careful to make an offer only if you intend to, and only with terms you are willing to meet. But an offer is not open to acceptance forever (fortunately); it terminates by:

i) Lapse – offeror states a date when the offer terminates; acceptance after that date is either disregarded or viewed as a new offer being made to the original offeror by the original offeree. If there is no stated period, it is based on what is "reasonable" according to the type of property or service, and local custom.

ii) Revocation – offeror withdraws the offer prior to acceptance, either expressly or by conveying other information that implies the offer has been revoked (*e.g.*, seller sold someone else the house in question) – or the offeree learns about it independently. The offer to form a bilateral contract generally can be revoked at any time unless/until the offeree agrees to accept. The offer in a unilateral contract technically can be revoked at any time before the offeree has completed the action the offeror specified, but courts tend to give the offeree who already has started that action (especially if expense was incurred) a chance to complete it before the offeror can revoke.

iii) Rejection by offeree. Rejection may be *outright*, or it may come in the form of a *counteroffer* (offeree changes some of the terms). If the original offeror accepts the counteroffer, there is still a contract.

iv) Operation of law – the death or mental incapacity of either party, or the destruction of the subject of the contract (*e.g.*, a factory that someone offered to buy is destroyed by a tornado before the offer is accepted, although if an offer already has been accepted a real estate buyer might bear the risk of destruction of the improvements prior to closing, and would be expected to pay anyway; in such a case it might be wise for the buyer to purchase insurance on the property even while the seller is still in possession).

b. *Acceptance* – offeree (who has "power of acceptance") agrees to abide by terms of the contract, as stated in the offer (which may have originated when the party who was the original offeree made a counteroffer to the original offeror). An acceptance that is not complete and unconditional generally is treated as a counteroffer, which the original offeror can choose to accept or reject. A home seller signed prospective buying couple Normiles' offer, but crossed out/replaced some key terms. The Normiles were unhappy with the changes, and delayed replying. When their broker later mentioned that the house had been sold to another buyer the Normiles signed the changed document and returned it to the seller. But a state appellate court ruled that they had no right to buy, because when the seller changed terms it became a counteroffer (the Normiles' original offer was no longer operative), and the broker's report that the house had been sold served to revoke the seller's counteroffer.[3] (If the Normiles had accepted the counteroffer without actually knowing the house already had sold the seller might have been in the difficult situation of being obligated to sell to two different buyers – as noted, be careful about making offers/counteroffers, and be sure to clearly revoke if revocation is intended.)

2. *Consideration* – technically, a *legal benefit foregone* or a *legal detriment accepted*. More informally, generally it is a party's payment of or promise to give up money or something else of value (*e.g.*, real estate, government bonds), accompanied by the other party's delivery of or promise to provide something valuable in return (*e.g.*, installing a new furnace, giving up title to real estate). Under what legal experts call "bargain theory," when each side gives something up for the other's benefit there is an exchange that makes both better off in some way and thus supports enforceability (only one side giving/promising to give something for the other's benefit is a gift situation, generally not enforceable). The term "consideration" reflects the idea that giving up something means the party has carefully *considered* the implications, and intends to be bound under the agreement. Characteristics of consideration:

a) May be money, securities, or even an agreement to act or refrain from acting in some specified manner.

b) Must relate directly to the agreement at hand; can not be in return for a previous favor. Example: *A*'s after-the-fact promise to give land to *B* who just voluntarily saved *A*'s life; generally *A* could back out later and rescuer *B* could not enforce this promise, because *B*'s act was unaccompanied by directly related consideration from *A*.

In a Michigan case a business property seller made a counter-offer to a real estate broker who presented an offer on a potential buyer's behalf. The counter-offer stated the broker had three days to secure a written acceptance from

the broker's client, but then the seller withdrew the counter-offer and sold to another buyer. The broker sued saying he was entitled to the three days to complete the sale (and earn a commission), but the court said the broker had no exclusive rights to deal with the seller, and that the broker had given no consideration for the promised three days.

c) Need *not* reflect an objective measure of economic value. Under an ancient Roman legal doctrine called *laeso enormis* (extensive harm) a harmed party can *rescind* a contract if the consideration is not reasonable in amount. This idea still applies under the civil law systems of some European countries, but it is not a feature of the English common law (court case precedents) system that is the foundation of contract law in the U.S.

3. *Reality of assent* – there must be a "meeting of the minds," and all parties must act of their own free will. If these elements do not exist, the wronged party can *rescind* (walk away from) the contract and demand the return of any consideration given. Rescission is justified by:

a) *Fraud* – intentional misstatement or concealment of a material fact, *e.g.* structural integrity of a house. House that floods after any heavy rain, "snake house" where snakes congregated every spring – though in one case when a seller failed to tell about a mold problem the court would not support the buyer's claim of concealment, because the seller did not overtly try to hide it and an inspection report the buyer paid for disclosed the problem. A buyer who has an inspection contingency but then does not have an inspection done could find it difficult to sue the seller for misrepresenting or concealing a problem that an inspection would have uncovered, and if a problem could easily be observed a buyer would have difficulty claiming there was misrepresentation or concealment. A court ruled that a city had no duty to disclose environmental contamination on land it sold, because the buyer or the buyer's broker could have learned of the problem by checking the state conservation agency's public records on contaminated land.[4] A seller's ultimately inaccurate prediction that a buyer will have great success with a commercial property (or "you'll never find a more well-designed house than this one") is likely to be seen by a court as an opinion, sometimes called "puffing," and not as a fraudulent misrepresentation of a material fact.

Fraud need not involve an outright lie verbally expressed; remaining silent about something deemed to be a material fact can be ruled fraudulent. In some states remaining silent about the fact that a violent death occurred on the premises would be fraudulent, although Illinois law treats a death having occurred at a house, from any cause, as non-material. (A seller or seller's agent can never lie if asked whether a death occurred at the site, and the web site *diedinhouse.com* is supposed to tell – for a fee – whether any death, from any cause, occurred at a given address.) Under laws in most states, including Illinois, a seller also generally is not required to tell a buyer that a house is reputed to be haunted unless specifically asked, but that result does not always hold in other states (and particulars can always lead to a ruling that deviates from the general case). A New York City bond trader offered $650,000 for a "vacant" old Victorian house in the town of Nyack, but then sued to rescind based on fraudulent misrepresentation when he learned, prior to a closing that he decided not to attend, that the home was known locally as haunted, and demanded his $32,500 earnest money deposit back (and sought additional monetary damages). The seller claimed that whether a property is haunted is a matter of opinion, but New York's highest state appellate court ruled in the "Ghostbusters" case that her history of telling neighbors and even media outlets (including *Reader's Digest*) that the property had benevolent ghosts made its status as haunted a material fact that needed to be disclosed; "as a matter of law, the house is haunted" for purposes of that transaction. The court also noted (wryly?) that the property was not vacant if it contained ghosts.[5] The buyer was found to have been defrauded and got back the deposit, but nothing extra (the court seemed to be awarding "out-of-pocket" damages, not a "benefit-of-the-bargain" award reflecting what the harmed party would have realized had the agreement been fulfilled).

[Yet publicity surrounding the case brought an interesting outcome: the seller received much higher offers from people who wanted haunted houses. (24% said in a survey that they would buy haunted homes.)[6] Subsequent owners, including singer Ingrid Michaelson, have reported no ghost sightings. In spring 2022 the Rhode Island farm house where paranormal events depicted in the film *The Conjuring* are alleged to have occurred sold for $325,000 above its $1.2 million asking price – and a condition of the sale (would it be legally enforceable?) was that the buyer could not live there, because the sellers said they feared it would be unsafe; the buyer planned to use the home to host events relating to the property's haunted reputation. A 2022 news article told of an old Gainesville, TX house, reportedly once an 1800s brothel, that the owners tried to rent out, but had constant tenant turnover because of the alleged presence of ghosts (some sex-obsessed, uttering comments from "oh baby, lookin' good" to the unprintable). After losing ten tenants in less than two years the owners took the property off the rental market, and now open it only for paranormal research.[7] The house on the east side of Bloomington, IL where four members of the Hendricks family were murdered in 1983 was called "spooked" by at least one of the fifteen subsequent owners.[8] Yet some owners seem to embrace the idea of tying their properties to the macabre; in early 2021 an upscale Newtown, PA house located across the street from a cemetery was for sale; pictures with the listing humorously showed skeletons

playing cards at a game table in an open basement area.[9]]

b) *Innocent misrepresentation* – material, but not intentional. Example might be a structural defect that the seller did not initially know about. Reporting 1966 *vs*. 1965 construction date probably is not material.

c) *Duress* – one party acts under threat to his/her safety or property, or the safety or property of a loved one. A woman claimed that spousal threats led her to sign the mortgage under duress (interestingly, she did not sign the promissory note) when they refinanced their home for $311,200. After they defaulted two years later, a state supreme court had to decide whether the husband's threats, made a day before the signing, constituted an immediate physical threat (in which case the bank's claim against the woman had been void as a matter of law) or left her with reasonable options (in which case the contract would have been voidable by the woman, but with the two years of making payments having constituted affirmation on her part).[10]

d) *Undue influence* – party was in a position of trust that facilitated taking unfair advantage of another. For undue influence to be proven, all of these circumstances must be present:
- Susceptibility to influence on one party's part
- Opportunity for other party to exert undue influence
- Disposition or tendency for party to exert undue influence (*e.g*., keeps victim isolated from other friends, relatives)
- Appearance that undue influence has occurred (*e.g*., actions that are totally out of character for the victim, like removing their children from will and leaving all property to a new caregiver)

[Questions of undue influence tend to arise when a person gives, or leaves in a will, real estate or other valuable property to someone other than closest relatives, or favors one immediate family member while excluding others.]

e) *Mutual mistake* – if *both* parties were in error, with regard to an important fact or assumption (otherwise it might be misrepresentation). Example might be an expectation both sides held that land could be rezoned when it could not. [The issue must be one of significance, the "efficient cause of the agreement" in one court's words, on which there never was a meeting of the minds; and it must be that one party still wants to enforce, or the two sides would just agree to tear up the contract.] Sewage backup problems led local health officials to disallow renting a small apartment property that recently had sold; neither seller Messerly nor buyer Pickles had known that the septic system put in by a prior owner was inadequate and did not meet building code. A state appeals court found that Pickles could rescind the purchase contract based on mutual mistake.[11] (But then two years later the state supreme court held that the contract's statement that the buyer had examined the property and agreed to accept it "in its current condition" allocated the risk of that type of problem to Pickles.)[12]

4. *Legally competent parties* – someone who is a minor, mentally ill, or extremely intoxicated does not have legal capacity to enter into a contract, and legally competent parties should not contract with them, because a party lacking competence could later *disaffirm*. For *minors*, contracts are voidable, even after they reach legal age (if they act within a reasonable time; otherwise they will be seen as having *ratified*). 20-year old J.O. Ware sold inherited land to older brother F.C., who lost ownership to a lender a year later by not repaying a loan on which the land was pledged as security. When J.O. sued to get the land back a few months after his 21st birthday the lender said he had not had notice that F.C got ownership from a minor, and the lender asserted that J.O. had ratified upon turning 21 (then age of majority in Georgia). But the state supreme court ruled J.O. was again the rightful owner, because he clearly had acted in a reasonable time after becoming of age, and despite the lender's innocence the voidability of minors' contracts took precedence; otherwise anyone wanting to evade contract law's protection of minors could just transfer property obtained from a minor to a third party.[13] (J.O.'s motivation seems to have been that F.C mortgaged the land without J.O.'s knowledge, and without ever having paid J.O. the agreed $100 price.)

Someone who lacks capacity and then disaffirms after buying something must return any property received (no matter what shape it is in, such as if a minor buys a car and then wrecks it), and then gets his or her money back – though courts sometimes reduce the amount returned to minors for damaged property, especially when a minor has lied about being of legal age. In fact, a minor who lies about his/her age could even be sued for damages. Contracts are voidable for an *insane person* who did not understand her actions but had not been judged legally insane (void by law if the person already had been judged insane). You would want to contract only with this person's legal guardian. A *drunkard* might avoid a contract entered into if so intoxicated as to not having understood what he/she was doing, as long as action is taken within a reasonable time of becoming sober and understanding earlier actions.

A state supreme court held that an offer to sell land for $50,000, hand-written on the back of a restaurant tab, was valid (so acceptance created a contract) even though the offeror claimed that it was meant to be a joke, and that the offeror and offeree were both very drunk at the time. What mattered to the court was whether the offeree was reasonable in thinking the offer was real; a factor considered was that the two discussed different prices over a

40-minute span, and that offeror Zehmer actually tore up a first draft and drew up a new one.[14] (Offeree Lucy had tried to buy Zehmer's land at various times in the past and Zehmer always refused; Zehmer said the "joking" aspect involved asking for subsequently higher prices as the two talked, leading to the eventual $50,000, which seems to have been considerably above market value – but still a price at which Zehmer did not want to sell. The reservation price, or personal or "investment" value, may have been much higher for both discussants than the market value.)

5. *Legal purpose* – if a contract is to be enforceable in court, its terms can not violate:

a) *Common law* – court case precedents. Example is contract for sale of a business property with an unreasonably restrictive covenant not to compete. The *Uniform Commercial Code*, which you may have discussed in business law courses, provides guidance in contract cases relating to the sale of goods – which are defined as being movable, so real estate is not legally classified as a "good" (contracts for services also are not covered under the UCC). A 1981 treatise from the American Law Institute called the *Second Restatement of Contracts*, written by top legal thinkers from that period, provides guidance to judges and lawyers in arguing/ruling on contract cases that include the sale of real estate.
b) *Statutory law* – laws passed by local, state, or federal legislative bodies. Example would be the illegality of the sale of land on a condition that the buyer not resell to racial or religious minorities.
c) *Public policy* – a violation of laws other than contract law, which would potentially harm people other than the parties to the contract; an example would be an agreement to make campaign contributions to a local politician in return for a favorable zoning decision.

Depending on circumstances, a contract with illegal provisions may be totally void, or the legal provisions may be enforceable, and only the illegal portions seen as void – likely the case in example b just above. Recall how an owner selling land might impose restrictive covenants or "deed restrictions" that bind all future owners; limiting use to agriculture is an example that a court likely would enforce. Decades ago it was not unusual for deed restrictions, particularly on houses sold in upscale neighborhoods, to prohibit a future sale to racial or religious minority group members. Those discriminatory exclusions were rendered illegal when fair housing statutes were enacted, but there is no way to erase the wording from older deeds that constitute part of the chain of title. So sales contracts can proceed and are enforceable, but the illegal restrictions are simply ignored; obviously courts would not enforce illegal and offensive restrictive covenants.

6. *In writing* – Since 1677, when the British Parliament enacted the first *statute of frauds* to reduce the chance that someone would be defrauded in a transaction, government jurisdictions (including essentially all 50 U.S. states) have required some contracts to be in writing *and signed by all parties* to be enforceable in court. A court's biggest concern in a contract case is verifying what the parties intended, and written documents provide the best evidence of what was intended when the agreement was struck. All real estate contracts come under statute of frauds provisions, though a verbal contract may become enforceable after one or both parties have substantially performed essential parts of the agreement, such that the intentions of the parties could be inferred clearly – like if a buyer "partially performed" by paying for land, taking possession, and starting to build improvements. And while oral evidence usually can not be used to change terms in a real estate contract that are spelled out in writing, a court might accept oral evidence to determine the parties' intent on matters not addressed in the contract's written documentation. A party also generally can waive a contract protection orally (or simply by not taking action when a violation occurs). In some cases a court will enforce a real estate contract even if it was not signed by the party trying to enforce it, as long as it was signed by the party trying to avoid it (you can not sign and later say you did not expect to be bound).

A contract for the sale of real estate may be an expressed agreement, or may be implied (deemed by the court to exist) through a series of other documents (signed letters, canceled checks that unquestionably relate to the same transaction). Parties, property, dates, and price should be clearly identified so a court can conclude that there was a genuine intent by both parties to transact. An Illinois appellate court held that an unsigned form contract with many blank spaces but showing a Mundelein lot's address and noting a $12,000 earnest money requirement, along with a cashed $12,000 check with the same date as the form contract and a memo line stating it was earnest money for the purchase of the indicated address, met the statute of frauds "in writing" requirement.[15] But in a Connecticut case there was an oral agreement for the sale of a $2,150,000 home, and the seller signed an authorization for the buyers to seek permits for construction on the property. When the seller rejected and returned unsigned, along with the buyers' earnest money, a written document purporting to repeat the oral agreement's terms, the buyers claimed they had an enforceable contract despite the statute of frauds, because they had partially performed ($4,850 spent on permits, with the seller's authorization). But the court stated that $4,850 was not material in a $2 million purchase; they could sue the seller to get that small sum back. And the uncertainty regarding the parties' intentions was shown by the seller's rejection of the written document. The court held that the seller had no obligation to sell to the buyers under the terms allegedly agreed to verbally. (Apparently the seller had received a higher subsequent offer.)[16]

Points to note:

- General rule is that mortgages, easements, and contracts for the sale of land (real estate) always have to be in writing to be enforceable in U.S. courts (as do sales of goods or other personal property for a price of $500 or more, and contracts that would necessarily require more than one year to be completed).
- While other contracts may be oral yet enforceable, proving what was agreed on in those situations can in some cases be quite difficult.
- A residential lease with a term of one year or less typically does not have to be in writing to be enforceable; this provision would seem to protect the parties who agree to go "month to month" after an initial year's lease period has ended. Standard one-year residential leases usually are not recorded, either (they often do not even qualify for recording), but the presence of the lessee and the lessee's belongings typically would provide "inquiry notice," to an innocent/unknowing third party, of the lessee's interest in the property.

II. Remedies for a Material Breach of the Contract

An important lesson from the *law and economics* field is that:

- To make efficient use of scarce and valuable resources in a society characterized by private property rights and the specialization of labor, we have to cooperate.
- To cooperate, people and organizations must be able to manage risks by planning, and to plan they must be able to rely on what cooperating parties say they will do.
- We can rely on others' statements only if there are benefits for doing what is agreed to and consequences for not doing what is agreed to. So we want to have enforceable agreements: contracts. But because we do not want people to be afraid to make agreements in our uncertain world, it might be wise to temper the severity of consequences for parties whose best efforts may fail when difficult circumstances arise.

A party that does not perform its obligations under an enforceable contract has *breached*, leaving the other party with various available legal remedies. [Performance does not always have to be exactly in keeping with the contract's wording for a court to say there has been no material breach; judges recognize, for example, that when a new structure is built the outcome will not be 100% to the buyer's liking. A party that has *substantially* met the steps to which it agreed typically is viewed as having substantially performed/not breached. Substantial performance in a complicated contract may be inferred if a party has done (at least made good faith efforts to do) the vast majority of what it promised or "warranted" it would do, and/or if the complaining party has realized most of the expected benefit. Instead of claiming material breach in such a case the unhappy party typically could legally just withhold the money needed to correct any problem; *e.g.*, a buyer could not totally refuse to pay a custom home builder that accidentally built a 640-square foot family room when 650 had been agreed to – but could pay the contract price minus the lost expected resale value from having a slightly smaller livable area.]

If there is a material breach in a contract for the purchase/sale of real estate, remedies include:

A. *For buyer* – if seller breaches, buyer may seek relief in the form of:

1. *Rescission* – the contract is terminated, and each side gets back any consideration it had provided (called "restitution"). One court allowed contract rescission when a firm installed a badly defective swimming pool; the home owner got his money back even though the contractor had no way to reclaim the pool.
2. *Specific performance* – the seller is ordered by the court to deliver a deed to the specified real estate, on the grounds that the buyer may need that unique property. Courts will order specific performance against a defaulting seller far more often than against a defaulting buyer. Land seller Perfect tried to rescind a sale based on mutual mistake, or alternatively increase the price or withhold some of the land, when a survey done after the contract signing showed the parcel to be 96 acres rather than the 81 he had told buyer McAndrew, but a court ordered specific performance at the originally agreed price since no per-acre price had been specified, and it was clear the seller meant to sell the entire tract.[17] (Also the judge stated that acreages listed with metes and bounds legal descriptions are notoriously inaccurate, as noted when we discussed this case in our legal description coverage – although a Maryland court ruled that while a seller was still required to sell when it became clear there was more land than initially believed, he was owed additional money.[18] But an Arizona seller who also had agreed to partially finance the buyer's purchase was not required to sell after the buyer and buyer's broker testified dishonestly about how the earnest money payment had been arranged; perhaps the court did not want to force the seller into a continuing relationship with an untrustworthy party.[19]
3. *Actual Damages – expectation damages* are a dollar amount received to place the buyer in a position equivalent to what would have been realized if the seller had performed under the contract. (Bea contracts to sell undeveloped land to Dee for $100,000 but then does not complete the sale, and Dee must pay $115,000 for a similar suitable parcel; Dee sues Bea for $15,000 in expectation damages. A court will award expectation damages only if they can be estimated with reasonable certainty and the breaching party could reasonably have foreseen the losses the harmed party would face. [The harmed party normally can not be granted specific

performance and also damages, although a court might order both if a land buyer suffered losses through a seller's delay in delivering a deed. And a court might order specific performance plus a price abatement or adjustment, for example if a seller can not deliver all the acreage agreed on.]

4. *Liquidated damages* – before signing the contract, the parties agree on the amount that a breaching party must pay. Courts have an aversion to liquidated damages, viewing them as potentially punitive, but they tend to enforce liquidated damages as a remedy for a contract breach if the amount specified seems reasonable in magnitude and if actual damages would be difficult to measure.

B. *For seller* – if the buyer breaches, the seller may seek relief in the form of:

1. *Actual damages – reliance damages* compensate a party for financial losses incurred because they relied on the breached contract. Examples would include added costs of holding the property until a new buyer is found. Technically, damages should relate to losses the harmed party suffered relative to market values at the time of the breach, which could differ from prevailing values at a later date, such as when a seller finds a new buyer after an initial buyer breaches. A coal company had agreed to return an owner's farm land to its natural state after it finished strip mining there, but a state supreme court ruled that the company could pay just the $300 estimated decline in market value rather than spending an expected $29,000 for reclamation work that would add only minimally to market value.[20] (The court claimed it was trying to prevent economic waste, but should specific performance not have applied?) More recently a prospective buyer breached its agreement to buy a McHenry County, IL commercial property, but the would-be buyer had paid rent to use the property between the contract signing and the date when it became clear the purchase would not be completed. A federal district court held that the rent received reduced the damages the seller could collect.[21]

(Jay signs a contract to buy Kay's house for $250,000 but then breaches, and Kay must sell for the next best offer of $225,000; Kay sues Jay for $25,000 in *expectation* damages. Per a provision in Elle's contract to buy Em's tool factory Em hires a sign company to paint "Elle Enterprises" on the building, but then Elle does not complete the purchase, so the expenditure adds no value in selling to another buyer; Em sues Elle for the $10,000 out-of-pocket costs for the sign painting as *essential* reliance damages, to put Em where she would have been if she had never had a reason to rely on the contract. Opie agrees to buy Estee's corner office building for $400,000 but then does not complete the purchase, and Estee pays $18,000 in extra marketing costs and property taxes over a few months before finding another buyer who offers $400,000; Estee sues Opie for $18,000 in *incidental* reliance damages.)

[Damages for contract breach are intended to make the harmed party financially whole, but nothing more. *Punitive* damages, which might be awarded in a *tort* case arising from someone's negligence, are not awarded for breach of contract – recall that society seeks to promote efficiency by encouraging people to form contracts, so we do not want to harshly penalize a party that fails to fully deliver despite what may have been honest attempts to do so. (But a breach could be so extreme that it becomes a tort, with punitive damages possible – an example might involve a home builder whose defective construction/negligence causes a buyer to suffer medical problems or emotional distress.) And in many contract breach situations harmed parties are expected to *mitigate* damages through actions like selling to a different buyer or buying from a different seller/supplier.]

2. *Liquidated damages* (perhaps a real estate buyer who fails to complete the purchase without appropriate justification forfeits any earnest money paid).

3. *Rescission* – terminate contract, and the seller returns the buyer's money. Generally, the seller would have to give the buyer back money received as a down-payment (the part of the purchase price paid from the buyer's own funds, rather than borrowed – although the down-payment usually would not be paid directly to the seller), but earnest money (a good-faith deposit paid directly to the seller that compensates the seller for taking the property off the market, applied to purchase price only if the sale is completed) might be retained by the seller.

It would be fairly unusual for a court to require a defaulting buyer to purchase real estate. Specific performance tends to be ordered as a remedy only when the court feels that the wronged party can not be made whole by money alone (a buyer may have no reasonable substitute when a seller does not complete an agreement to sell a unique parcel, whereas if buyer Q does not complete an agreed purchase the seller can be made whole by selling to later buyer R, and collecting monetary damages from Q for costs suffered through Q's not having performed as agreed). The Second Restatement of Contracts explicitly views every parcel of real estate as unique, such that money damages can not provide adequate compensation to a buyer when a seller breaches.

Specific performance might be a remedy for a harmed seller if the land was unusual or would be difficult to sell to another party, such that actual money damages suffered could be hard to estimate. In one case when a court ordered a reluctant buyer to purchase land, the contract actually listed specific performance as the remedy for a breach by

either party (the buyer was purchasing it as part of a mediated settlement to terminate an easement the seller held on the buyer's adjoining parcel). The buyer still tried to rescind by arguing that the house on the land had burned down and thus the seller had not met the condition of maintaining the property, in fact the seller received an insurance payout. But the court noted that the fire occurred three months after the initially scheduled closing date, with delays all caused by actions of the buyer – who apparently was trying to pressure the seller to sell to him at a lower price. Ultimately the court assessed the buyer almost $78,000 in interest and attorney fees.[22]

Economists sometimes argue that courts should make greater use of specific performance as a remedy for breached contracts generally, on the grounds that a judge may not know or understand just how much value the wronged party had placed on the original contract terms – we might think of it as a market value *vs*. investment value issue, as in *Peevyhouse v. Garland Coal and Mining Company* mentioned earlier, and in the *Jacob & Youngs v. Kent* case discussed below.

III. Types of Real Estate Contracts

Though a court might conclude that a contract exists through a combination of separate documents (letters, cancelled checks, *etc*.), a real estate contract is likely to be one specific document, often of a standard form type used in a specific locality. Such *form contracts* are acceptable, in fact probably desirable, to use if they serve parties' needs as effectively as a more customized document could. It is not unusual for the standard form contracts used in a given market area to have been designed jointly by a committee of attorneys and real estate brokers, and ultimately approved by their local or statewide professional associations. Then brokers can fill in the blanks (names, addresses, dates, dollar amounts, whether appliances remain) on these form contracts without being accused of engaging in the unauthorized practice of law.

A. *Listing Agreement* – a contract between a real estate owner and a broker, promising payment of a commission to the broker if the broker locates a buyer who is *ready, willing, and able* to buy. It is an employment contract that establishes a *special agency* relationship between the owner and the broker.

B. *Deposit Receipts and Offers to Purchase* – initial negotiating steps that precede official offers and counteroffers are likely to be conducted orally. But to form a contract that courts will enforce (recall the statute of frauds), there ultimately must be a written document showing offer and acceptance, and spelling out the important terms.

The party that draws up and signs the document is bound under the terms of the contract (as long as the offer remains open); the other party may accept or reject those terms. Acceptance may, strangely enough, be oral. But there must eventually be a signature or the contract becomes unenforceable. "Deposit receipt" is a more complete document than a mere offer to purchase, in that a deposit receipt acknowledges that earnest money has been paid, and spells out details regarding payment of the broker's commission. In Illinois, it usually is a document called a "proposal to purchase" that is used to make a binding offer. Under Illinois law, the word "offer" in a document prevents it from being a binding contract (seen as confusing).

C. *Contract for the Sale of Real Estate* – makes the transaction legally enforceable. Spells out the parties, the property, and all important terms (*e.g*., date when the buyer gains occupancy). It must specify:

a. *Seller* – with adequate legal proof that the party acting as the "seller" has title, and has authority to sell. It becomes especially important when the actual seller is a corporation or the beneficiary of a trust.
b. *Buyer* – with adequate proof that the buyer has contractual capacity (*e.g*., is not a minor) and is financially able to buy.
c. *Conditions* – something of a factual nature that must be fulfilled before a contract is complete. While a "promise" in a contract can be met with substantial performance, typically an explicitly stated "condition" can not; an express condition's not being met usually means that the harmed party can rescind (in the eyes of the law it might even be that the contract never came into existence) – unless a court rules the condition was minor such that violating it would constitute a nonmaterial breach, allowing the harmed party money damages but not rescission. A buyer who can put land to a desired use only if the zoning can be changed is likely to make an offer conditional on the zoning change being approved; if it is not then there is no obligation to buy. New York's highest appellate court ruled that a lessee's verbal notification that the lessor had approved a potential sublessee's proposed structural improvements did not constitute substantial performance when the contract required written notification by a specific date as a condition; the potential sublessee had no obligation to sublet.[23] And that same court held that an express condition allowing a home buyer to cancel a purchase by giving written notice within three days was *not* met with verbal notice while the written notice was still in the mail; the down payment the buyer had given the builder was forfeited.[24] (But in a case decades earlier the same court held that a home buyer

could not rescind his purchase just because some of the water pipes were of a brand different from what an express condition in the contract specified; the court determined that pipes the builder used were of comparable quality, such that the finished home's market value was not diminished, while requiring replacement of the noncompliant pipes would have imposed an enormous expense on the builder.[25])

So if a builder completes a 640-square foot family room under a contract that specified 650 square feet *as a condition*, the buyer should be able to rescind (getting back any money paid, with no obligation to buy), rather than just get a slight price reduction as in the earlier "substantial performance" example. A common condition in contracts for home sales is that the buyer can rescind, and get back any money paid, if she is unable to obtain financing under specified terms (including a minimum amount of principal needed and maximum interest rate to be paid), or if undisclosed problems are found in a home inspection, or if the buyer's current house can not be sold. "*Time is of the essence*" is a contract condition sometimes explicitly stated when real estate is sold. Courts recognize that delays can occur, so absent a time is of the essence clause either party typically can take additional (reasonable) time to be ready for a closing or to complete other obligations – like the seller needing a few days beyond the agreed possession date before the buyer can move in, or a buyer needing more time beyond a stated date to obtain financing – and be seen as having substantially performed and not materially breached.

d. *Quality of title* – typically fee simple, but whatever quality of ownership is required should be specified.
e. *Property description* – full and accurate legal description, if possible. The contract is void if the property can not be clearly identified. As we saw in our fixtures discussion, if the seller plans to take (or buyer expects seller to leave) any items whose status could fall into gray areas, those items should be addressed in the sales contract to prevent potential problems later. Separate contracts might be advisable for what generally is clearly personal property, like furniture or vehicles.
f. *Price* – how much money, and when it is to be paid. These items should be specified unambiguously, and any mortgages (pledge of the property to assure payment of a loan, to a bank or the seller) should be specified.
g. *Type of deed* – depends on quality of the seller's title (typically buyer expects to receive general warranty deed).
h. *Title exceptions* – any restrictions on the seller's title should be specified. There are always some (zoning laws, utility easements), but the buyer has a right to know what is being purchased. Especially important to note:
   - Leases – not usually recorded in public records unless they are long-term
   - Special tax assessments that have not yet been recorded (if recorded, then the buyer has *constructive notice*)
i. *Earnest money* – a good faith deposit that shows the buyer's offer is made in earnest, such that the seller can more confidently take the property off the market; *NerdWallet* suggests that earnest money typically would be 1 to 3% of the offer price.[26] As noted in an earlier section, if the contract is completed, earnest money is applied to the purchase price. If the contract is breached by the buyer, earnest money may serve as liquidated damages (usually paid to the listing broker, who has borne the marketing costs, including paying to advertise the property for sale).
j. *Prorating of items paid in advance and with positive balance at the date of closing* – home owner association dues that have been paid in advance, insurance premiums (if the buyer assumes the seller's policy), rents received (if rental property). [Note that a lender will not make a loan unless the borrower has proof of a homeowner or business insurance policy to cover possible losses.]
k. *Evidence of title* – the seller normally must provide evidence that title is good. Possible types of evidence:
   - *Abstract of title* – a history of a property's ownership based on publicly recorded transactions, from the government's original grant through the present owner. Prepared by a lawyer or an abstracting company.
   - *Attorney's opinion of title* – after examining abstracts and public records, an attorney writes a letter stating her opinion as to the title's quality.

   [Problem with abstracts and opinions: there is no "deep pocket" to sue if loss results from title searcher's error.]
   - *Title insurance* – an insurance policy that compensates a buyer's financial loss if title later is found to be defective. (Discussed in more detail in Topic 8 on closings and our Topic 17 insurance discussion.)
   - *Torrens certificate* – (named for Sir Robert Torrens in 19th century Australia). Title is registered with the county government, just like a car title is registered. Upside: once the government recognizes an owner, proof of ownership in subsequent transactions becomes easy. Downside: determining certifiable ownership the first time is a complicated process, involving public notices and court hearings. Torrens used to be seen in Cook County to some extent, but the county government no longer enters new Torrens registrations.
l. *Destruction clause* – specifies who bears the risk of loss in the property's value between the contract date and closing date; contracts generally assign that risk to the party in possession, which often would be the seller. One method is for the seller to pay for insurance, but with the buyer having the right to collect the policy proceeds and rebuild. The following is the actual wording of such a clause in a transaction that ended up in court over a range of contract and real estate law issues (including the meaning of "any" property when just one unit in a two-building apartment complex suffered severe damage when a fire occurred between the offer's acceptance date and scheduled closing date, and whether a buyer who rescinds by written notice and later *orally* proposes possible new purchase terms with the seller has withdrawn the rescission and is again bound by the original terms, or instead has made a totally new offer):[27]

> Damage or Destruction of Property: Risk of physical loss to the real estate and improvements shall be borne by Seller until closing, provided that if any property covered by this contract shall be substantially damaged or destroyed before this transaction is closed, Buyer may (a) proceed with the transaction and be entitled to all insurance money, if any, payable to Seller under all policies covering the property, or (b) rescind the contract and thereby release all parties from liability hereunder by giving written notice to Seller and Broker within ten (10) days after Buyer has written notice of such damage or destruction. Failure by Buyer to so notify Seller and Broker shall constitute an election to proceed with the transaction.

m. *Escrow provision* – needed if a third-party escrow agent will facilitate the transaction (common in California).
n. *Possession clause* – tells when the buyer gets possession.

IV. Special Topics Involving Real Estate Contracts

A. *Installment Land Contract, or "Contract for Deed"* – seller lends most of the purchase price to the buyer, and then retains title as security. The buyer does not *get* a deed; the buyer has a contract to purchase the property and get a deed *after* paying all installment payments owed. Agreement should include identifying information (property, parties, price) found in any contract. It also should specify that the buyer gets immediate possession, and it is best if a third party (escrow agent) holds the deed and can attest to when payments are received, because a defaulting buyer may lose all prior payments as liquidated damages – though a court might require a seller/lender who has received a large amount of the price to follow a foreclosure process that lets the buyer "redeem" by paying any amounts owed. Contract for deed sales have been criticized as onerous for their often low-income buyers, who can not get standard mortgage loans from banks and end up paying the sellers especially high interest rates. And if no equity is built up as payments are made, a buyer who can not afford to continue the payments can find it sensible just to move out.

B. *Option* – an option is an enforceable contract, in which the option holder pays the property owner a stated fee to keep an offer open at a stated price for a stated time – during which the option holder can investigate the market or the particular property, or see how various circumstances unfold. The option fee may or may not be applied to the purchase price. A seller retained an option to buy back land, either at the buyers' deaths or earlier if they wished to sell, at the price they had paid him. When the longer-living joint tenant died twenty years later a trial court agreed with her estate that it would be unconscionable to allow a repurchase for $8,000 when land values had risen so much over time. But the state's supreme court ruled that the original seller was entitled to specific performance (having it sold back to him at the $8,000 price), because the buyers had understood the terms and the seller had no undue influence over them.[28] (We also might recall that consideration need not relate to an objective measure of value.)

Similar to the option is the *right of first refusal* (ROFR), except that in the latter contract no stated sales price is specified; the party holding the right must meet the best terms offered by one or more other *bona fide* offerors by a specified date. Through two corporations (how rich people do things) celebrity ex-spouses Brad Pitt and Angelina Jolie jointly owned the French *chateau* and wine estate where they had married. Pitt sued Jolie in February 2022 for violating his alleged right of first refusal when she sold her 50% stake to a large spirits maker controlled by a Russian oligarch[29] – a type of individual not usually deferential in dealing with business partners.

So an option holder has a definite right to buy, but a right of first refusal holder has the right to buy only if the current owner wants to sell. In some jurisdictions if a rented house is put up for sale the existing lessee gets an automatic ROFR – the lessee has a legal right to remain in the house by buying it for a price that matches the best legitimate offer the seller receives. The bylaws of a high-end condominium complex are likely to grant an ROFR on all sales transactions to the owners' association so that the board of directors can prevent a sale from occurring at a price so low that it adversely affects the market's perception of other units' values. The existence of an ROFR can constrain the market/reduce the price when an owner wants to sell; a potential buyer may be reluctant to incur the substantial expense of making an informed bid (appraisals, engineers, *etc*.) on a major property if an ROFR holder could step in and pay the same price. Among legal questions that have arisen are whether the sale of all shares of stock in a corporation that held specified land as a primary asset, or a proposed trading of the applicable land for other real estate, constitutes a "sale" that triggers an ROFR. Real estate law experts recommend recording both options and ROFRs in county land records, to give third parties constructive notice that these rights are in effect.

C. *Contract for the Exchange* of Real Estate – similar to other purchase and sale contracts, except consideration is in the form of real property given up (and maybe added cash or personal property, known as "boot"). Transactors might complete a "like-kind exchange" of real estate instead of a traditional purchase/sale to save on federal income taxes. (This tax benefit is available only for income-producing real estate; no other types of assets qualify. See our Topic 18 on real estate investing for a more detailed discussion of this concept.)

D. *Assignment* – rights in a real estate contract normally are assignable (through gift, sale) to another party. An assignment can be useful to a buyer who wants an agent to negotiate in his place, perhaps to conceal the buyer's identity (*e.g*., a high-profile individual, or someone attempting to buy multiple parcels without attracting attention).

E. *Escrow arrangement* – oral or written contract under which buyer and seller agree to let a third party, the *escrow agent*, handle all money and documents. A neutral entity therefore can verify performance by all parties before the transaction is closed. Having an escrow also prevents problems in the event of the death or incapacity of one of the parties; the other party is dealing with the escrow directly, and dealing only indirectly with the other party to the transaction.

F. *Auction sales*. Modern farm land auctions can become quite complex, with a potential buyer being eligible to bid (with secret bids, not open outcry) to purchase the entire tract, bid to purchase one or more designated parts, or bid one price for the entire tract and other prices for specific desired portions. The final sale is based on the mix that gives the seller the highest total revenue, which could be a sale of the entire tract to one buyer or sales of smaller parcels to multiple parties. While agricultural land long has been sold at auction, in the past few decades it has become increasingly common for commercial real estate and even houses to sell through the auction process. A firm that played a pioneering role in selling real estate that was not either distressed property or agricultural land (examples: upscale homes, retail property, even large suburban high school Maine Township North) at auction was Sheldon Good & Company in Chicago.[30] Buyers of homes at auction sometimes are surprised to learn that they must pay an auction fee of 5 to 10% of the purchase price on top of that purchase price – so in planning for payment and financing they must allow for spending up to 10% more than their winning bids. ▪

---

[1] Philip E. Harris, *Wisconsin Agricultural Lease Law Primer*. https://polk.extension.wisc.edu/files/2014/02/Wisconsin-Agricultural-Lease-Law-Primer.pdf.
[2] Center for Agriculture and Food Systems, *State-Specific Leasing Issues*. https://farmlandaccess.org/state-specific-issues.
[3] *Normile v. Miller* (North Carolina appellate court, 1983).
[4] *Gavora v. City of Fairbanks* (Alaska supreme court, 2021).
[5] *Stambovsky v. Ackley* (New York appellate court, 1991).
[6] Mailman, Erika. "Is It Haunted? That's Between the Owner and the Ghosts." *The Wall Street Journal*, October 27, 2023, M1, M6-7.
[7] Crane, Emily. "Texas Couple Insists Their Home Is Haunted by 'Sexual' Ghosts Who Talk Dirty." *New York Post*, October 18, 2022.
[8] Flick, Bill. "The Day Bloomington 'Grew Up'." *The Pantagraph*, November 5, 2023, A1,8.
[9] Hollan, Michael. "Real Estate Listing Features Skeletons Displayed in House Across the Street from Graveyard." *Fox Business*, April 25, 2021.
[10] *Everbank v. Marini* (Vermont supreme court, 2015).
[11] *Lenawee County Board of Health v. Messerly* (Michigan appellate court, 1980).
[12] *Lenawee County Board of Health v. Messerly* (Michigan supreme court, 1982).
[13] *Ware v. Mobley* (Georgia supreme court, 1940).
[14] *Lucy v. Zehmer* (Virginia supreme court, 1954).
[15] *Jones v. Olsen* (Illinois appellate court, 1980).
[16] *Kelly v. Ryan* (Connecticut trial court, 1991).
[17] *Perfect v. McAndrew* (Indiana appellate court, 2003).
[18] *Bartlett v. Department of Transportation* (Maryland trial court, 1978).
[19] *Queiroz v. Harvey* (Arizona supreme court, 2009).
[20] *Peevyhouse v. Garland Coal and Mining Company* (Oklahoma supreme court, 1962).
[21] *Illiana Realty v. Whebbe* (Illinois federal district court, 2022).
[22] *Bender v. Rosman* (Montana supreme court, 2023).
[23] *Oppenheimer v. Oppenheim* (New York appellate court, 1995). An issue appears to have been that potential sublessee Oppenheim wanted to be free to sublet a new space that it had found.
[24] *Maxton Builders, Inc. v. LoGallo* (New York appellate court, 1986).
[25] *Jacob & Youngs v. Kent* (New York appellate court, 1921). We will revisit this case in our discussion of economics and real estate.
[26] Marquand, Barbara. "What Is Earnst Money?" *NerdWallet*, December 21, 2023.
[27] *Rosepark Properties, Ltd. V. Buess* (Ohio appellate court, 2006).
[28] *Emerson v. King* (New Hampshire supreme court, 1978).
[29] Kirkpatrick, Emily. "Brad Pitt Sues Angelina Jolie for Selling Her Stake in Chateau Miraval." *Vanity Fair*, February 18, 2022.
[30] "Maine North High School Going on Auction Block." *Chicago Tribune*, June 12, 1988. See also Greene, Bob. "A School of One's Own." *Esquire*, January 1989, 37-38.