



LEGAL UPDATE: Entitlements Don't Equal Consideration

By Doug White, Attorney

The California Third District Court of Appeal recently handed down an important decision for developers in *Steiner v. Thexton*. In this case, the Court declined to recognize a contract for the purchase of land because the developer maintained "sole and absolute discretion" to cancel the contract at any time before the close of escrow. The Court found that the contract was instead an attempt to create an option agreement. The option agreement failed, however, because it lacked consideration -- and the Court refused to recognize the developer's efforts to subdivide and entitle the land as adequate consideration.

Why is this decision important to developers, and what can we learn from it? First of all, it is important to remember that simply calling something a contract does not make it enforceable. In *Steiner*, the developer and landowner signed a document entitled, "Real Property Purchase Contract." The intention was to acquire approximately 10 acres of a 12-acre parcel of land in Sacramento County for a purchase price of \$500,000. These terms were found not sufficient to create a binding contract because the developer maintained the right to cancel the contract at any time before the close of escrow. The unilateral nature of the contract made it unenforceable -- albeit unintentionally -- and essentially it was found to be an attempt to create an option agreement, despite the fact that it was called a "Purchase Contract."

Second, this ruling reminds developers of the need to be cautious when entering into agreements that allow them to cancel contracts at any time during the transaction with little to no financial consequence. As happened in this case, a developer may inadvertently create an option agreement rather than an enforceable contract for the purchase of land.

Finally, developers should be aware that California courts may not accept the time, money, and expense associated with subdividing and entitling land as adequate consideration for either a pur-

chase contract or an option agreement. Courts tend to view such efforts as solely benefiting the developer, and not the landowner. Therefore, in order to create a legally binding agreement, something of consequence to the developer must be included and specifically identified as consideration in the contract.

So, how should we approach the negotiation and drafting of our purchase agreements? This case reminds developers and their attorneys of the importance of protecting themselves from expensive future contract disputes, and possibly even having their purchase contracts invalidated by a court. Keep the following things in mind when drafting and negotiating purchase contracts:

- A developer should never rely on their time, money, and expense entitling property to form the consideration necessary for a valid contract;
- Every purchase contract should explicitly describe the consideration for the purchase;
- Each contract should state that the parties understand and agree that the consideration described is both adequate and sufficient for the purchase of the property;
- Every agreement should specifically state that if the purchase contract is found to be invalid, the consideration in the agreement shall act as consideration for an option agreement; and
- Never execute a contract that explicitly allows you to back out of a transaction at any time and for any reason with little to no financial consequence. A contract that can't be enforced will only cost you time, money and heartache.

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