



Chapter 5



CONTRACTS



I. CONTRACTS IN GENERAL

Contract

- an agreement to perform or not to perform a certain act or service that is legally enforceable

VA 34

CLASSIFICATION OF CONTRACTS

A **CONTRACT** is an agreement to do or not to do a certain act or service.

EXPRESS CONTRACT

An agreement made either orally or in writing.

Examples: Listings, Deposit Receipts, Leases

IMPLIED CONTRACT (Not used in real estate)

An agreement is made by acts and conduct rather than by words.

BILATERAL CONTRACT

A promise made by one party in exchange for the promise of another party.

UNILATERAL CONTRACT

A promise to act made by only one party.

VALID CONTRACT - A contract that is binding and enforceable in a court of law.

VOIDABLE CONTRACT - Valid on its face, but one or more parties may reject it.

VOID - No contract exists, therefore no rights are enforceable.

UNENFORCEABLE - The contract cannot be proved or sued upon.

Express Contract

- Is expressed in words -- made verbally or in writing, but written contracts are preferred for:
 - Listings
 - Deposit Receipts/Purchase Agreements
 - Leases

Implied Contract

- Is created when an agreement is made by acts and conduct
- By implication; rather than words

Bilateral Contract

- Is made when one party makes a promise in exchange for the promise of another party

Unilateral Contract

- Is made when one party makes a promise without binding a specific person to performance
 - as when one offers a reward

A. Classification of Contracts

- **Valid** - contract is binding and enforceable
- **Voidable** - valid on its face, but one or more of the parties may reject it
 - Victim can rescind, annul, cancel
- **Void** - no legal force or effect; no contract exists, as it lacks an essential element
 - Also void if purpose is illegal
- **Unenforceable** - valid contract that cannot be enforced in court (proved or sued upon)

B. Life of a Contract

- There are three phases:

- Negotiation
- Performance
- Completed Performance

VA 35

LIFE OF A CONTRACT

PHASE I: NEGOTIATION PERIOD

Creation of a contract. Buyer and seller discuss possibility of a contract. If there is mutual interest, an offer, or perhaps several offers are made.

PHASE II: PERFORMANCE

Time between accepted deposit receipt and closing of escrow.

PHASE III: COMPLETED PERFORMANCE

The contract has been “executed.”

EXECUTORY - a legal agreement, the provisions of which have yet to be completely fulfilled

EXECUTED - a contract that has either been discharged or performed

EXECUTE - to sign a contract

EXECUTION - the act of performing or carrying out the contract

1. Negotiation

- Occurs before the contract has been struck
 - parties discuss the possibility of a contract
 - one or more offers are made
 - possibility of counter offers
 - an offer is accepted by all parties
 - a contract is created provided all contractual elements are present

2. Performance

- Terms of the contract to be fulfilled; the contract is in “mid-stream” and is said to be executory (the period of waiting for all)
 - remains *executory* until payment is made and deed transferred, at which point, it becomes *executed*

3. Completion

- Occurs after a contract has been completed (executed) and extends until the statute of limitations runs out

Terms used in contracts

- Executory – contract to be performed
- Execute -- is to sign a contract
- Execution -- is the act of performing or carrying out the contract
- Executed Contract – is one that has either been discharged or performed

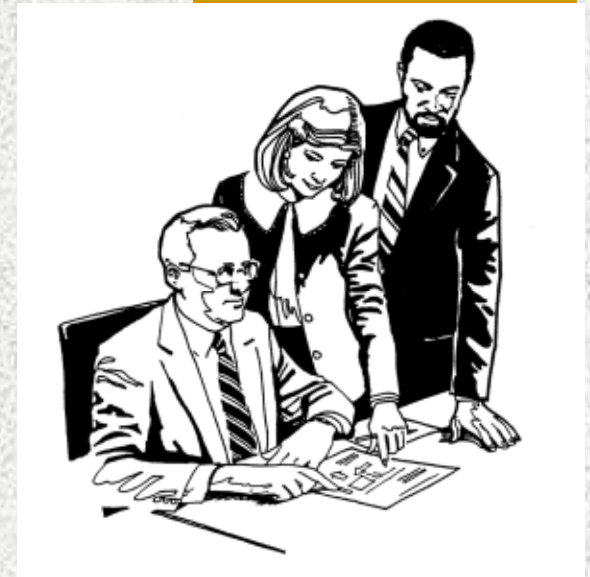


II. ELEMENTS OF A CONTRACT

II. Elements of a contract

In a contract, it is imperative to remember that the following are NOT essential elements of a valid contract:

1. money (can be other consideration)
2. writing (except for real estate contracts)
3. performance



II. Elements of a contract

- There are 5 essential elements to any valid real estate contract as defined by the California Civil Code
 - Capacity
 - Mutual Consent
 - Legality
 - Consideration
 - Writing Sometimes Required (Statute of Frauds)

A. Capacity

- Refers to all persons legally permitted to sign a contract; everyone (even people who are not citizens of the U.S.) is capable except:
 1. **Minors** – anyone under the age of eighteen (except emancipated minors – those with contractual rights of adults)
 - Through marriage (survives divorce), armed forces service, declared self-supporting by courts
 2. **Incompetents** – persons judged to be of unsound mind
 3. **Convicts** – persons serving terms of imprisonment
 - may convey property with the approval of the California Adult Authority
 - civil rights are lost during the course of the jail term

A. Capacity cont'd

- Minors and Incompetents can acquire real property by gift or inheritance
- Contracts with minors are VOID because a minor cannot delegate authority
- With incompetents, a guardian's decision regarding a real estate contract must be approved by the court

B. Mutual Consent

- A genuine offer by one party, genuine acceptance by the other party, and a meeting of the minds.

1. Offer

- An expression of willingness to enter into a contract
- **OFFEROR** – is the person (buyer) who has made the offer
- **OFFEREE** – is the person (seller) to whom the offer has been made

Contractual Intent

- exists when the offeror communicates an offer to the offeree with the intention of forming a binding contract
- contractual intent does not exist with:
 - social invitation
 - advertisement
- Offeror/Buyer can withdraw offer anytime prior to receiving communication of its acceptance by Offeree/Seller

Terms

- Must be **definite and certain** (if the main details of the sale are missing, a judge/court will not fill-in or fix them)
 - termed an illusory contract if terms are not definite and certain; unenforceable
- A real estate contract must contain:
 - price
 - specific financing terms
 - an accurate description of the property

2. Acceptance

- Is the absolute and unqualified consent to the offeror's terms by the offeree
- Offeree must know he or she has been made an offer before they can legally accept
 - silence cannot be acceptance because a party cannot be forced to express rejection of an offer
 - acceptance must be communicated in the manner specified in the offer
 - any counter-offer automatically constitutes rejection of the previous offer

3. Termination of an Offer

Offer terminates upon the occurrence of any of these:

- Lapse of Time - offer is not accepted within the time period specified in the offer
- Communication of Revocation - offer can be terminated/revoked/withdrawn by offeror at any time before offeree has communicated acceptance
- Failure of Offeree to Fulfill a Condition - all specified conditions must be completed in the prescribed manner within timelines specified
- Rejection - offeree rejects or makes a counter offer
- Death or Insanity - of either party (offeror or offeree) prior to acceptance voids the offer
- Illegality of Purpose - if any condition or purpose of the contract is deemed illegal, the contract is void/terminated

4. Genuine Consent

- Both offer and acceptance must be genuine and real
 - if not, contract is void or voidable by victim

- Genuine Consent does not occur in cases of:
 1. **Fraud** - when a person misrepresents a material fact knowing that it is not true
 2. **Mistake** - when both parties are mistaken as to the matter of the agreement or where subject of agreement ceases to exist
 3. **Duress** - the unlawful detention of a person or his property
 4. **Menace** - a threat to commit duress or injury
 5. **Undue Influence** - when a person in a position of authority, such as a broker or salesperson, uses that authority to an unfair advantage

C. Legality

- The requirement that a contract be legal in both formation and operation
 - not against the law
- Consideration and objective of contract must be lawful
 - Contracts based on unlawful consideration are void

D. Consideration

- Usually anything of value given by one party to another to make for a binding agreement
 - does not have to be \$\$\$
- But does need to be:
 - a benefit to a party of the contract or another person
 - a loss suffered or agreed to be suffered
 - an agreement not to bring a legal suit
- If a promise is the price paid, it must be a promise for a promise

E. Proper Writing

- The law states that personal property contracts may be either written or oral, but almost all real estate contracts **must be in writing to be enforceable**.
- Statute of Frauds specifies those contracts required to be in writing (See Figure 5.2 in text)
 - personal property contracts (e.g., rental agreements) for one year or less need not be in writing – if it cannot be performed within one year, it must be in writing

Statute of Frauds

- Requires real estate contracts and other contracts to be in writing in the following cases:
 - a. any agreement where the terms are not to be performed within one year from the date of signing
 - b. a promise to answer for the debt, default or non-performance of another (co-sign)
 - c. an agreement made upon the consideration to marry someone
 - d. an agreement for the sale of real property or for a leasing of real property for more than one year
 - e. an agreement employing an agent to buy, sell or lease real property for a period of more than one year
 - f. an agreement not to be performed during the life of one of the parties
 - g. a mortgage note or trust deed
 - h. any sale of personal property for more than \$500

1. Parol Evidence Rule

- Assumes written agreement to be complete and final expression of rights and duties of all parties to a contract (can be contemporaneous with oral agreements)
- Prohibits the introduction of any prior agreements as evidence in a court action that contradict or modify terms of written contract
- Except, the court will allow such evidence only if the contract:
 1. is incomplete
 2. is ambiguous
 3. may not be enforceable because of mistake or fraud
- Pre-printed clauses superseded by handwritten clauses



III. PERFORMANCE, DISCHARGE, AND BREACH OF CONTRACT

A. Performance of a Contract

- The successful completion of a contractual duty within time limits imposed (*time is of the essence*), usually resulting in the performer's release from any past or future liability
- Most contracts are performed and discharged without legal complication
- If difficulties arise, settlements are usually arrived at
 - either by the parties, themselves
 - with or without aid of legal counsel
- If not settlement, the courts may be the final arbiter

A. Performance of a Contract (cont'd)

ASSIGNMENT – the transfer of a person's right in the contract in process to another party

- Assignor – has original contract but transfers rights (while maintaining secondary liability) to Assignee
- Personal service contracts (listings) are not assignable
- **NOVATION** – original contracting party wishes to drop out completely; new contract is substituted for the existing contract with intent of canceling original contract by mutual consent; requires full performance by new/substitute principals

A. Performance of a Contract (cont'd)

- Revocation is the canceling of an offer to contract (i.e., before acceptance) by the original offeror

B. Discharge of A Contract

- Occurs when the contract has been terminated in one of the following ways:

VA 37

DISCHARGE OF A CONTRACT

FULL PERFORMANCE

Completed according to the terms of the original agreement.

SUBSTANTIAL PERFORMANCE

Almost (but not quite) completed.

PARTIAL PERFORMANCE

If both parties agree to the value of the work partially completed, the contract is discharged.

IMPOSSIBILITY OF PERFORMANCE

Cannot be completed.

AGREEMENT BETWEEN THE PARTIES

Contract not completed—parties discharge contract by mutual agreement.

OPERATION OF LAW

If a contract or parts of a contract become illegal, it is discharged.

ACCEPTANCE OF BREACH

One party lets the other party out of the contract.

BREACH

One party will not go through with the contract.

B. Discharge of A Contract (cont'd)

- Statute of Limitations (see Fig. 5-5)
 - any civil action for breach of contract must be initiated within the time frame specified in the Civil Code
 - failure to do so renders injured party with no recourse under the law



IV. REMEDIES FOR BREACH OF A CONTRACT

REMEDIES OF A BREACH

(NOT GOING THROUGH WITH A CONTRACT)

- 1. ACCEPTANCE OF BREACH** (FORGET THE WHOLE THING)
- 2. UNILATERAL RESCISSION**
(CONTRACT CANCELED - EVERYTHING REVERTS TO ITS ORIGINAL POSITION)
- 3. ACTION FOR DOLLAR DAMAGES**
(MOST LAWSUITS ARE FOR MONEY)
- 4. POSSIBLE ACTION FOR SPECIFIC PERFORMANCE** (JUDGES RARELY FORCE PEOPLE TO GO THROUGH WITH A CONTRACT TO SELL THEIR PROPERTY)

A. Acceptance of Breach

- A discharge of a contract may be simply the acceptance of the breach
- The wronged party does not pursue legal action
 - possibly due to the fact that the recoverable damages do not justify the cost of litigation
 - possibly due to the fact that the other party is 'judgment-proof'
 - possibly due to the determination that the psychological costs may not be worth the remedy available

B. Unilateral Rescission

- The legal grounds for rescission are:
 - fraud, mistake, duress, menace, undue influence, and faulty consideration
- Rescission is possible when:
 - the contract is unlawful for causes not apparent on its face
 - the parties are not equally at fault
 - the public interest would be hurt
- Minors or incompetents may generally rescind their contracts

C. Action for Dollar Damages

- Occurs when a court suit for breach requests payment of a fixed amount of money as compensation
- A Liquidated Damages Agreement - sets in advance a specified amount of money as a penalty in the event of a breach (current max of 3% for home purchase agreements)

D. Specific Performance

- Courts will only consider this option if dollar damages cannot provide an adequate remedy
 - party causing breach is forced (through court action) to perform the terms of the contract
 - remedy must be mutual -- both parties must perform (or have already performed) per the terms of the contract
- Contract must be shown to be “just and reasonable”
- Contract must have been based on adequate consideration

V. THE RESIDENTIAL PURCHASE AGREEMENT

A. The Offer and Acceptance (with Deposit)

- Is an offer and deposit to purchase a specific property on certain terms and conditions
- When acceptance is communicated to the Buyer, becomes a binding contract on both Buyer and Seller
- Spells out commission to be paid to brokers
- When using preprinted forms, the handwritten parts have control over the printed parts, and all corrections must be initialed by both parties

B. The Deposit

(Consideration for Deposit Receipt)

Collected as consideration from prospective buyer on behalf of the seller to bind the contract to purchase (basis for collection of liquidated damages)

- Covenants – promises, obligations, or considerations exchanged between parties to fulfill a contract
 - failure to perform does not relieve either party from their responsibility; injured party may sue for damages

- Contingencies, Conditions, or Subject to -- provisions in a deposit receipt by which all parties are released from any obligation in the event that some stated occurrence fails to materialize
 - usually the availability of financing w/ appraisal at value
 - clearance of inspections
 - sale of another property

C. The Purchase Agreement Addendum

- A form used as an addendum to either the Residential Purchase Agreement, another offer form, or a counter offer form
- Covers 6 topics occasionally relevant to a transaction:
 1. cancellation of prior sale; back-up offers
 2. seller to remain in possession after close of escrow
 3. tenant to remain in possession
 4. junior or assumed financing
 5. short sale
 6. court confirmation

D. The Counter Offer Form

- Is used instead of completing an entirely new deposit receipt when a counter offer is made.
 - the offeree becomes the offeror
 - a contract negotiation may involve several counter offers

E. Inspection Advisory for Buyers (Environmental Hazards)

- As professionals, real estate agents have a duty to advise buyers to exercise reasonable care to protect themselves
- Physical inspections of the property are the single most important part of the due diligence process
- Any known defects by agents must be disclosed to the buyer
 - failure to do so exposes agent to civil action for two years after the fact



VI. SELLER/AGENT REQUIRED DISCLOSURES

Disclosure Forms

- Beyond the Transfer Disclosure Statement (TDS) and Supplement to the TDS, there are a multitude of disclosure forms that may typically be required in a residential real estate transaction
- For an alphabetical listing, refer to pages 144 and 145 in your textbook



VII. PURCHASE OPTIONS

A. Purchase Option (a unilateral contract)

- An OPTION is an exclusive right to purchase or lease a property (taking it off the open market) upon specified terms within a specified time, which is granted in exchange for money
 - Optionor – property owner who gives interested buyer the right to the purchase or lease of a property
 - Optionee – potential buyer who purchases the sole privilege to buy or lease in an agreed-to period of time

A. Purchase Option

(a unilateral contract)

- Obtain a preliminary title report to ensure owner can convey clear title
- If option is exercised, Option Agreement will become the sales contract
- Optionee (if an agent/salesperson must disclose anticipated profit to seller/Optionor and also convey all offers and material information to seller
 - may also secure another buyer for the property; transferring all rights without consent of seller/Optionor
- If Optionee determines they will not complete purchase, Optionor should obtain a quitclaim deed recorded to remove option from public record

HOMework

- Read Chapter 6
- Study for quiz
- Next class, bring in comparison of C.A.R and Professional Publishing Purchase Agreement forms

Chapter 5 Summary

■ Contract Types:

- Expressed
- Implied
- Bilateral
- Unilateral
- Valid
- Voidable
- Unenforceable

■ 3 Contract Phases:

- Negotiation
- Performance
- completion

■ 4 Elements:

1. Capacity
2. Mutual assent
3. Legality
4. Consideration

■ Contract is voidable:

- Fraud
- Misrepresentation
- Mistake
- Duress
- Menace
- Undue influence

Chapter 5 Summary (cont'd)

- Statute of Frauds
 - RE contracts be in writing
 - Performed within 1 year
- Contracts can be discharged:
 - Performance
 - Breach
 - Acceptance of breach
 - Operation of law
 - Agreement between parties
- Remedies for breach:
 1. Acceptance
 2. Unilateral rescission
 3. Action for \$\$
 4. Specific Performance
- California Residential Purchase Agreement
- Joint Escrow Instruction
- Means of relieving obligations
 - Covenant
 - Contingency
 - Conditions
- Options
 - Optioner
 - Optionee