

6 Transfer of Interests in Real Property

CONTRACTS IN GENERAL

Probably no other phase of the law is as important to parties who are transferring real estate, real estate brokers and salespersons as the law of contracts. Every transaction of any consequence almost invariably includes one or more contracts. It is important, therefore, to understand their nature and to be well acquainted with some of the broad rules governing contract creation, operation and enforcement.

In this chapter we consider contracts in general. Chapter 7 focuses on contracts used most frequently in the real estate business.

Contract Defined

Any term as broad in its application as “contract” is difficult to define with precision. California’s Civil Code states: “A contract is an agreement to do or not to do a certain thing.” The American Law Institute offers this definition: “A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.” Still another authority on the subject, Corbin, submits a definition which combines the foregoing two versions: “A contract is an agreement between two or more persons consisting of a promise or mutual promises which the law will enforce, or the performance of which the law in some way will recognize as a duty.” This latter can serve as our working definition, and its meaning will be clarified later when we analyze the essential elements of a contract.

Classification. It will be helpful to review certain terms which are commonly used to classify contracts. With reference to *manner of creation*, a contract may be *express* or *implied*.*

In an express contract, the parties declare the terms and put their intentions in words, either oral or written. In an implied contract, however, the agreement is shown by acts and conduct rather than words. (In a hurry, you enter the corner drugstore, where you have an account, pick up a pack of gum, wave it at the clerk; the clerk nods and you leave. There is an implied contract that you will pay for the gum later.)

With reference to *content of the agreement*, a contract may be *bilateral* or *unilateral*. A bilateral contract is one in which the promise of one party is given in exchange for the promise of the other party. (A tells B, “I’ll give you \$300 if you will promise to paint my house” and B so promises.) In a unilateral contract, on the other hand, a promise is given by one party to induce some actual performance by the other party. The second party is not bound to act but if the second party acts, the former is obligated to keep the promise. (A offers a reward of \$100 to anyone who will find and return A’s lost dog. B does not make any promise but just happens to find and return the dog. A must pay B \$100.)

With reference to *extent of performance*, a contract may be *executory* or *executed*. In an executory contract, something remains to be done by one or both parties. In an executed contract, both parties have completely performed.

Finally with reference to *legal effect*, contracts may be classified as *void*, *voidable*,

* Contract implied in fact should be distinguished from contract implied in law. A contract implied in law evidences obligations created by law for reasons of justice. A contract implied in law would be the foundation of an employee’s claim against a deceased employer’s estate for overtime wages.

unenforceable, or *valid*. A *void* agreement is not a contract at all. It lacks legal effect (e.g., an agreement to commit a crime; or, in California, an attempt by a minor under 18 to make a contract relating to real property). A *voidable* contract is one which is valid and enforceable on its face, but one which one or more of the parties may reject (e.g., certain contracts of minors are voidable at the option of the minor; a contract induced by fraud may be voided by the victim). An *unenforceable* contract is valid, but for some reason cannot be proved or sued upon by one or both of the parties (e.g., a contract that cannot be enforced because of the passage of time under the statute of limitations). A *valid* contract is one that is binding and enforceable. It has all the essential elements required by law.

ESSENTIAL ELEMENTS OF CONTRACT

Under the Civil Code of California it is essential to the existence of a contract that there be:

1. Parties capable of contracting;
2. Their consent;
3. Lawful object; and
4. A sufficient consideration.

It may be helpful to add a fifth requirement which is present only in certain contracts: a proper writing.

Parties Capable of Contracting

For a valid contract, there must be two or more parties who have at least limited legal capacity. Generally everyone is fully capable of contracting, except persons who are subject to certain limitations [unemancipated minors, persons of unsound mind, aliens and persons deprived of civil rights (e.g., convicts)].

Minors. A minor is a person under the age of 18 years. A minor is either unemancipated or emancipated (set free from parental control/supervision) under the Emancipation of Minors Law.

An unemancipated minor (hereafter “minor”) cannot give a delegation of power, make a contract relating to real property or any interest therein, or relating to any personal property not in the minor’s immediate possession or control. With certain statutory exceptions, a minor may disaffirm any contracts entered into during minority or for a reasonable time after reaching majority. In case of a minor’s death within that period, the minor’s heirs or personal representatives may disaffirm any contract into which the minor entered.

A minor is deemed incapable of appointing an agent; therefore, a delegation of authority (e.g., a power of attorney) is absolutely void. A real estate broker could not serve as agent of a minor to buy or sell. A broker could represent an informed adult in dealing with a minor, but the client must be willing to hazard the possibility of having the contract voided. Difficulty can be forestalled by negotiating in real property with or for a minor only through a court-appointed guardian. For the minor’s protection, such negotiations cannot be concluded by the guardian without court approval.

Emancipation of Minors Law. Under this law (Family Code Sections 7000, et seq.) emancipated minors have certain powers to deal with real property and are considered as being over the age of majority for certain purposes, including: entering into a binding contract to buy, sell, lease, encumber, exchange, or transfer any interest in real or personal property; conveying or releasing interests in property.

An emancipated minor is a person under 18 years of age who has entered into a valid marriage (even though terminated by dissolution) or is on active duty with any of the armed forces of the United States of America or has received a declaration of emancipation by petitioning the superior court of the county where he or she resides.

Brokers dealing with minors must proceed cautiously and should seek the advice of their attorney.

Incompetents. California law provides that after the incapacity of a person of unsound mind has been judicially determined, no contract can be made with such person until restoration to capacity. Similarly, a person who is entirely without understanding but has not been judicially declared incompetent has no power to contract.

In dealing with incompetents concerning real property, proper procedure calls for appointment of a guardian and court approval of the guardian's acts.

Note: Both minors or incompetents, however, may acquire title to real property by gift or by inheritance. They may convey, mortgage, lease or acquire real property pursuant to a superior court order obtained through appropriate guardianship or conservatorship proceedings.

Aliens. In California, resident or nonresident aliens have essentially the same property rights as citizens. Section 671 of the Civil Code provides that "any person, whether citizen or alien, may take, hold, and dispose of property, real or personal, within this state." In the federal law, however, there are certain restrictions on the property rights of aliens.

Convicts. Persons sentenced to imprisonment in state prisons are deprived of such of their civil rights as may be necessary for the security of the institution in which they are confined and for the reasonable protection of the public.

Convicts do not forfeit their property. They may acquire property by gift, inheritance or by will, under certain conditions, and they may convey their property or acquire property through conveyance.

Individual proprietors. The bulk of the nation's business is conducted by *individual proprietors*, by ordinary *partnerships*, by *corporations*, and, more recently, by *limited partnerships* and *limited liability companies*. The first category presents no special problems. The owner who is a sole proprietor takes title in his or her own name, or, if married, the spouse may join as a grantee.

Partnership. In a partnership, two or more persons carry on a business as co-owners. The partnership may exist if such intention can be proven whether or not the partners have reduced their agreement to a formal writing. The more important characteristics of a *partnership* are: its lack of separate capacity to deal independently from its members (with certain exceptions hereafter noted); customary equal participation of members in management; co-ownership of partnership assets; individual interest of each partner in profits and surplus; and the mutual agency relationship between partners making each the agent of the others insofar as partnership business is concerned.

Partnership property constitutes the originally invested and subsequent partnership acquisitions. The best practice in investing in property usually is to take title in the name of the partnership itself. However, title may also be taken in the individual name of one or more partners, or in the name of a third party as trustee for the partnership. Although any authorized partner may then dispose of the property, it is customary for all partners to execute the instrument of transfer.

If property is acquired in the partnership name, it should not be transferred until a “GP-1 form” is filed with the Secretary of State and then recorded in the recorder’s office showing the names of the partnership and its members.

The Uniform Partnership Act of 1994 became effective January 1, 1997. All partnerships formed prior to January 1, 1997 remained governed by the old Uniform Partnership Act (Corporations Code Section 15001, et seq.) until January 1, 1999. On that date, the old Uniform Partnership Act was repealed and all partnerships were governed by the Uniform Partnership Act of 1994 (Corporations Code Section 16100, et seq.).

Of course, if title to real property is in an individual’s name, both the individual and such person’s spouse should sign the instrument of transfer.

In order to enjoy some of the benefits of incorporation yet retain the partnership form, it is possible to form a “*limited partnership*.” This can be achieved only by filing a formal certificate. Limited partners may not allow their names to be used in the business and may not participate in the control of the business. If all legal requirements are met, the limited partners are not responsible for partnership debts beyond their investment. At least one partner must be a general partner with unlimited liability.

Limited liability companies. The Beverly-Killea Limited Liability Company Act (California Corporations Code Sections 17000–17705) allows the formation of limited liability companies. It became effective, generally, in September of 1994.

To form a limited liability company, two or more persons must enter into an operating agreement and must execute and file articles of organization with the California Secretary of State.

The name of a limited liability company must contain, at the end, either the words “limited liability company” or the abbreviation “LLC”. The words “limited” and “company” may be abbreviated to “Ltd.” and “Co.,” respectively.

Subject to any limitations contained in the articles of organization and to compliance with any other applicable laws, a limited liability company may engage in any lawful business activity, except the banking, insurance, or trust company business. (Corporations Code Section 17002)

Corporations Code Section 17101 sets forth the liability of members of a limited liability company. In part, the liability parallels that of shareholders in a corporation, while the company is treated as a partnership for tax purposes.

Corporations. The more important characteristics of a *corporation* are: separate capacity to deal with property independently from its members; centralized control in a board of directors; liability of shareholders normally limited to the amount of their investment; freely transferable shares; and continued existence regardless of death or retirement of its shareholders.

Although a corporation may take title to property in its own name, it is an “artificial person” created by law, and must function through human agents. Accordingly, corporate control is vested in the board of directors and so it becomes important to have some evidence of the board’s decision in connection with the proposed property transaction.

The decisions of the board are usually in the form of resolutions authorizing certain officers to deal with the corporate property. It should be noted that since a corporation has perpetual existence, it is not permitted to take title to property in joint tenancy with right of survivorship.

Note: Some corporations are organized on a nonprofit basis. Members of such a *nonprofit corporation* are not personally liable for the debts or obligations of the corporation, and in many respects such an organization is similar in operation to a regular corporation. A board of directors controls its property and conducts its affairs. The corporation may enter into contracts and acquire and dispose of real or personal property in its own name.

Nonprofit associations. Sometimes transactions in real property will involve *nonprofit associations*: loosely knit, unincorporated associations of natural persons for religious, scientific, social, educational, recreational, benevolent or other purposes. Members of such associations are not personally liable for debts incurred in acquisition or leasing of real property used by the association, unless they specifically assume such liability in writing. These nonprofit organizations may, by statute, hold such property in the group name as is necessary for business objects and purposes and may so hold nonessential property for 10 years.

When an unincorporated association proposes to dispose of property, the conveyance should, in the case of benevolent or fraternal societies or associations, be executed by its presiding officer and recording secretary under seal after resolution duly adopted by its governing body. In the case of other incorporated associations for which no other provision is made by statute, conveyances may be executed by the president or other head, and secretary, or by other specific officers so authorized by resolution. Such an association may record a statement setting forth its names and the persons authorized to execute conveyances. California Corporations Code Sections 20003 through 24007 govern unincorporated associations organized under California law.

Personal representative. A final category of parties to contracts, and one of considerable importance, is that of *personal representatives of decedents*. A person who leaves a will may name an *executor* or *executrix* to carry out its provisions. If a person dies intestate or fails to name an executor, the probate court will appoint an *administrator* to administer the estate. The acts of these officials are generally subject to court supervision. Real estate agents usually come in contact with executors and administrators when the latter are interested in selling a parcel of real estate belonging to the estate.

Mutual Consent

The second element of a valid contract is that the parties who have capacity to contract shall properly and *mutually consent* or assent to be bound. This mutual consent is normally evidenced by an offer of one party and acceptance by the other party. An *offer* expresses the offeror's willingness to enter into the contract. It must of course be *communicated* to the offeree. It must, moreover, manifest a *contractual intention*. There need not be a true "meeting of minds" of the parties, for they are bound only by their apparent intentions outwardly manifested by words or acts. Courts cannot read minds, and secret or unexpressed intentions, hopes and motivations are immaterial. However, the assent must be genuine and free, and if it is clouded or negated by such influences as fraud or mistake the contract may be voidable at the option of one or both parties, depending on the circumstances.

Sometimes when negotiating a contract, some of the terms might be left for future determination or there might be a condition which must be met before the parties become obligated (this may be called a "condition precedent"). In any of these situations, it is

usually held that there have been only preliminary negotiations, mutual consent has not been reached and a binding contract has not come into existence. In such cases even the courts cannot guess what the parties will mutually agree upon.

Definite contract terms. Finally, the offer must be *definite and certain* in its terms. The precise acts to be done must be clearly ascertainable. Courts cannot make contracts for the parties, nor fix terms and conditions. The offer must be “nonillusory” in character, that is it must actually bind the offeror if it is accepted.

If the offeror could cancel or withdraw at pleasure without reasonable notice, the offer would be illusory. Another example would be an offer/promise completely within the offeror’s control to perform or not to perform, such as an offer to buy a property “contingent upon obtaining a \$100,000 loan.” Without more conditions and specificity, the offeror might not even apply for a loan. To avoid illusion, clauses in the contract should carefully specify the details of the condition and should contain promises by both parties to provide some semblance of mutuality. A clause in a deposit receipt conditioning the offer upon the obtaining of a loan by the offeror should include the amount of the loan the buyer desires, interest rate, monthly installments, how secured, type (i.e., FHA, VA or conventional), an agreement by the buyer to use best efforts to procure such a loan and an agreement by the seller to cooperate in such efforts.

On many occasions, California courts have refused to enforce contracts because of uncertainty.

In one case, a broker provided in a deposit receipt that there was to be a first deed of trust in a fixed amount to a bank, and a second to the seller for the balance. Interest in each case was fixed. Then the contract stated “total monthly payments including interest, to be \$95.” Specific performance was denied because the deposit receipt was silent as to what portion of the \$95 was to be paid to the bank and what to the seller.

Another agreement was drawn which was certain in all particulars except that it provided that the balance of the purchase price was to be evidenced by a first and second mortgage. The agreement was silent as to the amount of each mortgage and the uncertainty was critical because the parties disagreed as to the amounts of each mortgage. The court refused to enforce the agreement.

Another contract was found to be too uncertain because it was silent as to the rate of interest on the deferred balance and as to the date of maturity of the indebtedness.

Uncertainty and insufficiency were found in which a form was used containing a provision that an “extension of time for 30 days may be granted by (blank)”. Since either party could extend, the court held that no one was in fact authorized.

Provisions in a contract that the property is to be improved with streets, water system, other utilities, and paved boulevards are too indefinite for enforcement. The court will not determine where the streets are to run, or how many there are to be, or the area to be covered or how they are to be constructed.

Description of property. The problem of certainty and definiteness may be acute in connection with land identification. A broker may not have the deed by which the owner acquired property, or the title report or policy connected with it. The contract must, however, contain such a description, or at least include a unique aspect of the property agreed to be sold so that it can be exactly ascertained. Where the broker has a former title policy or a preliminary report, he should refer to the description by the title company’s name and policy number. From such a mention or reference, it can be ascertained what property is meant. Oral evidence may be resorted to in court for the purpose of identifying

the description, but not for the purpose of ascertaining and locating a missing description, or one too uncertain to be identified.

For example, it is very common to describe property by the street and house number: No. 19, 10th Street, city, county and state. Usually, this will be sufficient. However, if the seller has a large property with more than one building on it, or an adjoining lot, the description would be insufficient. “My house and lot on 10th Street, between A and B Streets” would be sufficient provided the owner had no other house and lot on that block. “My land consisting of 96 acres located about four miles northeast from Porterville, California” was held sufficient to enable the court to determine what land was meant, because that was all that the seller had in that vicinity.

Termination of offer. The hope of the offeror is that the other party will accept and a contract will be formed. But the offeror does not want to wait indefinitely, and need not. The offer may be terminated in any one of a number of ways:

1. **Lapse of Time.** The offer is revoked if the offeree fails to accept it within a time period prescribed in the offer. If the offer does not include a deadline for acceptance, the lapse of a reasonable time without communication of acceptance may cause the offer to be considered to have been revoked. What is a reasonable time is a question of fact dependent upon the circumstances.
2. **Communication of Notice of Revocation.** This can be done anytime before the other party has communicated acceptance and is effective even if the offeror said the offer would be kept open for a stated period of time which has not yet elapsed. If the offeree pays to keep the offer open for a prescribed period of time, we have an *option* and the offeror must abide by its terms.

Sometimes an offer is made to sell and the person to whom the offer is made later acquires reliable information that the property has been sold to another party. This, too, constitutes a revocation.

3. **Failure of offeree to fulfill a condition prescribed by the offeror or to accept in a prescribed manner.** If the offeree makes a qualified acceptance (as by changing the price), in effect a counteroffer is made and the original offer is dead. It cannot later be accepted, unless revived by the offeror repeating it. Thus the roles of the parties are exchanged, and the counteroffer itself may then be terminated like an original offer. It should be noted here that this discussion of offer and acceptance, and the rest of the discussion as to formation of contracts, may not apply to contracts between merchants for the sale of goods. These are governed by the California Uniform Commercial Code.
4. **Rejection by the offeree.** An unequivocal rejection ends the offer, but simple discussion and preliminary bargaining do not do so when they involve no more than inquiries or suggestions for different terms.
5. **Death or insanity of the offeror or offeree causes revocation of the offer.**

Acceptance. Acceptance is the proper assent by the offeree to the terms of the offer.

Obviously, the person to whom the offer is made must have knowledge of it before he or she can accept. Acceptance by anyone other than the offeree is not possible. Most contracts are bilateral, but interesting problems arise in connection with the less common unilateral variety where the offeror asks for action, not a promise. Normally, when the requested act is performed, the offer is automatically accepted. But if the offeree doesn't intend an act to be an acceptance, or if there is no knowledge of the offer, there can be no

acceptance and no contract. This sort of thing might happen when one returns a lost dog without even seeing the ads offering a reward for its return.

Acceptance must be absolute and unqualified, for if it modifies the terms of the offer in any material way, it becomes a counteroffer. As already noted, this terminates the original offer. Indeed, if the acceptance is too late or otherwise defective, the person making the offer cannot waive the delay or defect and treat the relationship as a binding contract.

Acceptance must be expressed or communicated, though it may be sufficient without actually being received by the person making the offer. Silence cannot be regarded as an acceptance of an offer ordinarily, because the party making the offer cannot force the party to whom an offer is made to make an express rejection. Silence may amount to an acceptance when the circumstances or previous course of dealing with a party places the party receiving the offer under a duty to act or be bound. Acceptance may be made by implication as by the acceptance of a consideration tendered with an offer.

Acceptance of an offer must be in the manner specified in the offer, but if no particular manner of acceptance is specified, then acceptance may be by any reasonable and usual mode.

A contract is made when the acceptance is mailed or put in the course of transmission by any other prescribed or reasonable mode (e.g., by deposit of a telegram for transmission). This is so even though the letter of acceptance is lost and never reaches the party making the offer, as the acceptance has been placed in the course of transmission by the offeree.

Genuine assent. The final requirement for mutual consent is that the offer and acceptance be genuine. The principal obstacles to such *genuine or real assent* are fraud, mistake, menace, duress or undue influence. If any one of these obstacles is present, the contract may be voidable and a party to the alleged contract may seek rescission (restoring both parties to their former positions) or dollar damages or possibly reformation of the contract to make it correct.

Fraud. Fraud may be either actual or constructive in nature. Normally, fraud exists when a person misrepresents a material fact while knowing it's not true, or does so with careless indifference as to its veracity. A person must misrepresent with the intent to induce the other person to enter the contract, and the other must rely thereon in entering the contract. "Material fact" means an important fact which significantly affects the party's decision to enter into the contract.

Civil Code Section 1572 lists the following five acts which would be deemed *actual fraud* when done by a party to a contract or with his or her connivance with intent to induce another to enter into the contract, or even simply to deceive such other party:

1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
2. The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true though the person believes it to be true;
3. The suppression of that which is true, by one having knowledge or belief of the fact;
4. A promise made without any intention of performing it; or,
5. Any other act intended to deceive.

Ordinarily, misrepresentation of law does not amount to actionable fraud, no doubt

because everyone is presumed to know the law. Nevertheless, this may be actionable fraud where one party uses superior knowledge to gain an unconscionable advantage, or where the parties occupy some sort of confidential relationship, even though the guilty party is not a strict fiduciary.

Constructive fraud. Constructive fraud as defined in the Civil Code may consist of first, any breach of duty which, without an actual fraudulent intent, gains an advantage for the person in fault or anyone claiming under that person by misleading another to the other's prejudice or to the prejudice of anyone claiming under the other person. Second, it may consist of any such act or omission as the law specifically declares to be fraudulent without respect to actual fraud. The element of reliance is essential, and where it is shown that no commitments were made until independent investigation by others, there can be no action claiming fraud. Negligent misrepresentation has also been held to be a species of fraud.

A distinction should be made between fraud in the inception or execution, and fraud in the inducement of a contract. For example, if the promisor knows what he or she is signing and the consent is induced by fraud, the contract is *voidable* by the promisor; but if the fraud goes to the inception or execution of the agreement so that the promisor is deceived as to the nature of his or her act and actually does not know what is being signed, and does not intend to enter into a contract at all, it is *void*. Where the contract is voidable, it is binding until rescinded, while if the contract is void, a formal act of rescission is not necessary.

If one signs a contract without reading it and therefore fails, through carelessness or negligence, to familiarize oneself with the contents of a written contract prior to its execution, relief is denied. Where such failure or negligence is induced by the false representation and fraud of the other party to the contract so that its provisions are different from those set out, the court, even in the absence of a fiduciary or confidential relationship between the parties, may reform or cancel the instrument.

A party to a contract who has been guilty of fraud in its inducement is not relieved of the effects of the fraud by any stipulation in the contract, either that no representations have been made or that any right which might be grounded upon them is waived. Such a stipulation or waiver will be ignored, because the fraud renders the whole agreement voidable, including the waiver provisions.

False representations. Where false representations are made by an agent and the contract contains a recital limiting the agent's authority to make representations, the innocent principal may, by certain stipulations, be relieved of liability in a court action for damages for fraud and deceit, but the defrauded third party may nevertheless rescind the contract. The guilty agent may, of course, be liable in damages for the wrongful act.

Mistakes. Another possible obstacle to genuineness of assent is mistake. Where both parties are mistaken as to the identity of the subject matter of the contract, there can be no contract. Where the subject matter of the agreement has, unknown to the parties, already ceased to exist, so that performance of the contract would be impossible, there is no contract.

Mutual agreement as to the subject matter is the basis of a contract. If the parties to an agreement consent thereto, a contract results. However, the contract may be voidable if there is a substantial mistake as to some basic or material fact which induced the complaining party to enter into it. Negligence of the injured party does not in itself preclude release from mistakes, unless the negligence is gross, as where the party simply

fails to read the agreement. One who accepts or signs an instrument which is on its face a contract is deemed to assent to all of its terms and cannot escape liability on the ground of not having read it. This is true only in the absence of such influences as fraud, undue influence, or duress.

Mistakes are classified in the Civil Code as mistakes of fact or of law. A *mistake of fact* is one consisting of ignorance or forgetfulness of a fact material to the contract, but which is not caused by the neglect of a legal duty on the part of the person making it. Or it may consist in the mistaken belief in the existence of a thing material to the contract, or a belief in the past existence of such a thing, which has not existed. A *mistake of law*, on the other hand, is described as one which arises from a misunderstanding of the law by all parties involved, all making substantially the same mistake while thinking they knew and understood the law.

A mistake may also be a misunderstanding of law by one party, which the other party is aware of but does not rectify.

Duress, menace, undue influence. Sometimes a contract may be rendered voidable because it was entered into under the pressure of duress, menace or undue influence. All three, in effect, deprive the victim of the free exercise of will, and so the law permits such person to void the contract, as well as other remedies under the law.

Duress involves coercion or confinement. While duress is technically the unlawful confinement of persons or property, modern case law has expanded duress to include unlawfully depriving a person of the exercise of free will. Economic compulsion or duress may result in a finding that a contract provision is unconscionable.

Menace consists of a threat to commit duress, but also includes threat of unlawful and violent injury to a person or the person's character.

Undue influence is unfair advantage taken by someone who has the confidence of another, or who holds a real or apparent authority over another. It may involve taking an unfair advantage of another's weakness of mind, or in taking a grossly oppressive and unfair advantage of another's necessities or distress. Undue influence is most frequently encountered in connection with contracts between persons in confidential relationships, where the victim is justified in assuming the other party will not act contrary to the victim's welfare. The relationships which usually fall within this rule include trustee and beneficiary, broker and principal, attorney and client, guardian and ward, parent and child, husband and wife, physician and patient, employer and employee.

Lawful Object

Assuming now that parties are capable of contracting and have properly manifested their consent through an offer and acceptance, the validity of their agreement might still be attacked on grounds of legality. The contract must be legal in its formation and operation. Both its consideration and its object must be lawful. The object refers to what the contract requires the parties to do or not to do. Where the contract has but a single object, and that object is unlawful in whole or in part, or is impossible of performance, the contract is void. If there are several distinct objects, the contract is normally valid as to those parts which are lawful. An object is not lawful that is contrary to an express provision of the law, or contrary to the policy of express law.

In general the law will lend its resources to neither party involved in an illegal contract. Thus if a contract is executory and illegal, neither party may enforce it; if it is executed, neither party may rescind and recover consideration. But sometimes the law which was violated was designed to protect one of the parties; or the parties are not equally

blameworthy; or one party repents and calls the deal off before any part of the illegal object has been realized. In such cases, the law will provide appropriate relief.

Common violations. The objects and consideration of a contract must be legal and not violate some specific prohibition of the law. If such violation does occur, its effect upon the contract may depend upon the particular statute involved. Two types of situations in the real estate field involving statutory violations are:

1. Contracts of unlicensed “brokers” or “general contractors.” These persons are not permitted to enforce their contracts.
2. Forfeiture clauses in deposit receipts, contracts of sale and leases.

(A contract clause which specifies a fixed amount of damages in the event of a breach is known as a liquidated damages clause. Except as discussed below, a liquidated damages clause is presumed valid unless the party seeking to invalidate the provision proves that it was unreasonable under the circumstances existing at the time the contract was made.

A liquidated damages clause is void if the liquidated damages are sought to be recovered from: (1) a party to a contract for the retail purchase or rental of personal property or services primarily for that party’s personal, family, or household purposes; or (2) a party to a lease of real property for use as a dwelling by that party or his or her dependents.

Special rules apply to liquidated damages provisions in contracts for the purchase of residential real property. These rules are explained below in the Section entitled “REAL ESTATE CONTRACTS.”

Special rules apply to liquidated damages clauses in construction contracts with certain government entities, making provisions for amounts to be paid for each day of delay in construction valid unless manifestly unreasonable at the time the contract was made.)

3. Contracts by which one is restrained from engaging in business may be void, although a person selling goodwill may promise the buyer not to compete within a reasonably limited area for a specific period of time.
4. Persons may not generally avoid responsibility for their own fraud or negligence merely by so providing in a contract.
5. A contract calling for the payment of interest in excess of the California Constitution’s current limits may be usurious depending upon the identity of the lending entity and the purpose of the loan. If such a contract is usurious, that portion of the contract relating to the payment of interest is void.
6. In addition to the foregoing, brokers must be careful to comply with the numerous regulatory measures incorporated in the Real Estate Law. Specific violations may prevent enforcement of a listing contract. It should be noted that violations of law not only affect the enforceability of the contract involved, but may also subject the violator to criminal punishment.

Sufficient Consideration

Even if the agreement meets all the requirements of a valid contract already discussed, it may fail because of the lack of sufficient consideration. In general, every executory contract requires consideration. The consideration may be either a benefit conferred, or agreed to be conferred, upon the person making the promise, or any other person; or a detriment suffered or agreed to be suffered. It may be an act of forbearance or a change in legal relations. It is the price bargained for and paid for a promise, and it may, of course,

be a return promise. If a valid consideration exists, the promise is binding even though some motive other than obtaining a consideration induced the promisor to enter into the contract.

Ordinarily, the nature of the consideration is reflected in the written agreement of the parties. The consideration must have some value. A purely moral obligation may under some circumstances be consideration. There is no requirement of adequacy to make the contract enforceable. Thus, an option to purchase valuable property may be given for consideration of one dollar or some other nominal sum. It is only in an action for *specific performance* that the amount is important, and in this event the equitable remedy will be denied unless an adequate consideration is proved. Also, gross inadequacy of consideration may be a circumstance which, together with other facts, will tend to show fraud or undue influence.

In a unilateral contract, a promise of the offeror is consideration for an act or forbearance sought from the offeree. In a bilateral contract, a promise of one party is consideration for the promise of another, and generally any valid promise, whether absolute or conditional, is sufficient consideration for another promise.

STATUTE OF FRAUDS

Contracts That Must Be Written

The law is more concerned with substance than with form. With reference to form, it is generally immaterial whether a contract is oral or written or even manifested by acts or conduct. Thus all contracts may be oral except those specially required by a statute to be in writing.

Most contracts which by statute are required to be in writing are referred to as coming under the Statute of Frauds. The Statute of Frauds was first adopted in England in 1677 and became part of the English common law. Subsequently, it was introduced into this country and has been codified in California. The purpose of the California Statute of Frauds is to prevent perjury, forgery and dishonest conduct on the part of unscrupulous people in proving the existence and terms of certain important types of contracts.

The statute provides that certain contracts are invalid, unless the contract or some note or memorandum of the contract is in writing and subscribed (i.e., signed) by the party to be charged or by his or her agent. Under Section 1624 of California's Civil Code, contracts that are required to be in writing are:

1. An agreement that by its terms is not to be performed within a year from the making thereof;

2. A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in Civil Code Section 2794;
3. An agreement for the leasing for a longer period than one year or for the sale of real property, or of an interest therein. Such agreement, if made by an agent of the party sought to be charged, is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged;
4. An agreement authorizing or employing an agent, broker, or any other person, to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where such lease is for a longer period than one year, for compensation or a commission;
5. An agreement which by its terms is not to be performed during the lifetime of the promisor;
6. An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of said indebtedness by the purchaser is specifically provided for in the conveyance of such property.
7. A contract, promise, undertaking, or commitment to loan money or to grant or extend credit, in an amount greater than one hundred thousand dollars (\$100,000), not primarily for personal, family, or household purposes, made by a person engaged in the business of lending or arranging for the lending of money or extending credit. For purposes of this section, a contract, promise, undertaking, or commitment to loan money secured solely by residential property consisting of one to four dwelling units shall be deemed to be for personal, family, or household purposes.

Relates to remedy. It should be noted that the Statute of Frauds relates to the remedy only and not to the substantial validity of the contract. Thus, the contract which fails to comply with the statute is not void but merely *unenforceable*. This, of course, is an important distinction. It is effective for all purposes until, in an attempt to enforce it by action, its invalidity is urged. Moreover, the statute is a defense only and cannot be the basis for affirmative action. It has been held that significant partial performance can excuse the lack of a writing.

When a contract has been fully performed, the Statute of Frauds does not apply and may not be invoked for any reason.

The note or memorandum required by the statute may be in any form since its purpose is simply evidence of the contract. It may consist of one paper, or even a series of letters. It must however contain all the material terms of the contract so that a court can determine to what the parties agreed. It must, of course, bear the signature of the party to be charged or held to the agreement. The other party bringing the action can always add his or her signature later.

Real estate applications of the statute. It is readily apparent that several very important sections of the Statute of Frauds apply to persons dealing in real estate. Practically all contracts for the sale of any interest in real property must be in writing. This includes assignment of a percentage of the proceeds of oil produced from designated lands. It would embrace any and all instruments creating liens, such as trust deeds, mortgages, leases for periods of longer than one year, rights to rights of way through property and any and all encumbrances incurred or suffered by the owners, or by operation of law. "By operation of law" means judgments, attachments, or restrictions placed on the property by

legislative bodies, zoning ordinances, and other such means.

The statute does not apply to a lease for a year or less.

Commissions. The Statute of Frauds provides that in order for a broker to collect a commission when earned, the contract providing for a commission must be in writing and signed by the party to be charged: e.g., a property owner who employs the broker to produce a buyer; or a buyer who employs the broker to find a suitable property.

The Statute of Frauds is applicable to situations where the lease of real estate for a period longer than one year is involved. A broker who is commissioned to seek a lessee of property for a term longer than one year cannot rely upon an oral agreement to collect a commission. If the broker is successful in negotiating the lease, the contract with the lessor must be in writing or there must be reliable written evidence thereof in order to sustain a claim of commission.

It has been held that the moral obligation to pay for services performed under oral authorization is sufficient consideration to support a promise of compensation contained in escrow instructions later drawn up. It also has been held that these provisions have no application to an oral agreement between brokers to share a commission to be earned as a result of the sale or exchange of real estate.

The Statute of Frauds invalidates any unwritten agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon that property unless assumption of the indebtedness is specifically provided for in the property conveyance.

INTERPRETATION, PERFORMANCE AND DISCHARGE OF CONTRACTS

The majority of all contracts are properly performed and discharged or executed without legal complications. If difficulties arise, the parties themselves, or with the aid of legal counsel, will typically work out an amicable settlement. But the courts remain available for the resolution of conflicts between contracting parties that cannot be so settled. Set forth below are some of the rules which guide the courts in their *interpretation* of contracts.

Interpretation of Contracts

In general, contracts are interpreted so as to give effect to the mutual intention of the parties as it existed at the time of contracting, insofar as that intention is ascertainable and lawful. A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates. But the language of the contract governs its interpretation, if the language is clear and explicit and does not involve an absurdity. Obviously the language should be reduced to writing, for the wiles of the unscrupulous are infinite, and the memory of every man and woman is finite and fallible.

Fortunately, as noted earlier, most contracts of interest to real estate brokers must be in writing under the Statute of Frauds. A broker can render valuable service by seeing to it that the writing clearly expresses the intention of the parties. But when a written contract fails to express the real intention of the parties because of fraud, mistake or accident, the courts will seek to discover the real intention and disregard the erroneous parts of the writing.

The execution of a contract in writing, whether the law requires it to be written or not, supersedes all the negotiations and stipulations concerning this matter which preceded or accompanied the execution of the instrument. When a contract is partly written and partly printed, written parts control the printed part, and the parts which are purely original

control those which were copied from a form. If the two are absolutely contradictory, the latter must be disregarded.

Modification or alteration of a contract is a change in the obligation by a modifying agreement which requires mutual assent. A contract in writing may be altered by a new contract in writing, or by an executed oral agreement, and not otherwise.

Parol evidence rule. Parol evidence refers to prior oral or written negotiations or agreements of the parties, or even oral agreements contemporaneous with their written contract. The parol evidence rule prohibits the introduction of any extrinsic evidence (oral or written) to vary or add to the terms of an integrated written instrument such as a deed, contract, will, etc. This rule helps to finalize agreements with certainty, and it discourages fraudulent claims. On the other hand, the courts will permit such outside evidence to be introduced when the written contract is incomplete or ambiguous, or when necessary to show that the contract is not enforceable because of mistake, fraud, duress, illegality, insufficiency or failure of consideration, or incapacity of a party.

Under the “*parol evidence rule*,” when a contract is expressed in a writing which is intended to be the complete and final expression of the rights and duties of the parties, parol evidence is not admissible as evidence.

Where the parties come to an agreement by mistake or fraud, and the written instrument does not express their agreement correctly, it may be reformed or revised by the court on the application of the party agreeing to it, provided that this can be done without prejudice to rights acquired by third persons in good faith and for value.

Performance of Contracts

In connection with *performance* of contracts, it is not uncommon to find a party who would prefer to drop out of the picture without terminating the contract. Under proper circumstances this may be accomplished by assignment or by *novation*.

Assignable contract. Whether the contract is assignable depends upon its nature and terms. Ordinarily, either a bilateral or a unilateral contract is assignable unless it calls for some personal quality of the promisor, or unless it expressly or impliedly negates the right to assign. The contract might expressly provide that it shall not be assigned or it may contain provisions which are equivalent to such expressed stipulations, or it may require consent to assign.

The effect of assignment is to transfer to the assignee all of the interest of the assignor. The assignee stands in the shoes of the assignor, taking assignor’s rights and remedies, subject to any defenses which the obligor has against the assignor, prior to notice of the assignment. Where the subject matter of the assignment involves reciprocal rights and duties, the assignor may transfer the benefit and may divest himself or herself of all rights, but cannot escape the burden of an obligation by a mere assignment. The assignor still remains liable to the obligee; even if the assignee assumes the obligation, the assignor still remains secondarily liable as a surety or guarantor, unless the obligee releases the assignor.

The assignment carries with it all the rights of the assignor, thus the assignment of a note carries with it any incidental securities such as mortgages or other liens.

In some cases the original contracting party who wants to drop out completely may do so by *novation*.

Novation is the substitution by agreement of a new obligation for an existing one, with

intent to extinguish the latter. The substitution may be a new obligation between the same parties, and/or a new party, either a new debtor or a new creditor. A novation requires an intent to discharge the old contract and, being a new contract, it requires consideration and other essentials of a valid contract.

Where one party is indebted to another and the creditor takes a promissory note for the sum owed, this does not discharge the original debt unless the parties expressly so agree, or unless such intention is clearly indicated. No particular form is required ordinarily for a novation. It may be written or implied from conduct where the intent sufficiently appears.

Time

The question of time is often significant in contracts. By statute, if no time is specified for the performance of an act required to be performed, a reasonable time is allowed. If the act is in its nature capable of being done instantly, it must be performed immediately upon being exactly ascertained, unless otherwise agreed.

If the last day for the performance of any act provided by law to be performed within a specified period of time shall be a holiday, then such period is extended to the next day which is not a holiday.

Discharge of Contracts

In the matter of *discharge* of contracts, there are two extremes, *full performance* and *breach of contract*. Between these extremes are a variety of methods of discharge of the contract including the following:

1. By part performance;
2. By substantial performance;
3. By impossibility of performance;
4. By agreement between the parties;
5. By release;
6. By operation of law; and
7. By acceptance of a breach of the contract.

Statute of Limitations

The running of the *Statute of Limitations* will bar any legal action seeking relief for a breach of contract. Civil actions can be commenced only within the periods prescribed by statute after the cause of action shall have accrued. The policy of the law is to aid the vigilant. The person who “sleeps upon his rights” may be barred from relief by this statute. The following is a summary of some of the clauses which are of special interest to real estate brokers.

Actions which must be brought within 90 days. Civil actions for the recovery of or conversion of personal property such as baggage alleged to have been left at a hotel, boarding house, lodging house, furnished apartment house or furnished bungalow court, shall be commenced within 90 days from and after the departure of the owner of the personal property.

Within six months. An action against an officer, or officer defacto, to recover any goods, wages, merchandise or other property seized by the officer in an official capacity as tax collector, or to recover the price or value of any such goods or other personal property, as well as for damage done to any person or property in making any such seizure. Also

actions on claims against a county which have been rejected by the board of supervisors.

Within one year. An action for libel, slander, injury or death caused by wrongful act or neglect of another, or by a depositor against a bank for the payment of a forged or raised check.

Within two years. An action upon a contract, obligation or liability not founded upon an instrument in writing (other than open book accounts, accounts stated, and open, current and mutual accounts, where the limit is *four* years); or an action founded upon a contract, obligation or liability, evidenced by a certificate or abstract or guaranty of title of real property or by a policy of title insurance; provided, that the cause of action of such contracts shall not be deemed to have accrued until the discovery of the loss or damage suffered by the aggrieved party thereunder.

Within three years. Included are: an action upon a liability created by statute, other than a penalty or forfeiture; an action for trespass upon or injury to real property; an action for taking, detaining, or injuring any goods or chattels, including actions for the recovery of specific personal property; an action for relief on the grounds of fraud or mistake. (Cause of action does not accrue until discovery by the injured party of the facts constituting the fraud or mistake.)

Within four years. An action upon any contract, obligation or liability founded upon an instrument in writing except an action upon any bonds, notes or debentures issued by any corporation or pursuant to permit of the Commissioner of Corporations, or upon any coupons issued with such bonds, notes or debentures, if such bonds, notes or debentures shall have been issued to or held by the public, where the limit is *six* years; also provided that the time within which any action for a money judgment for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage, may be brought shall not extend beyond *three* months after the time of sale under such deed of trust or mortgage.

An action to recover:

1. Upon a book account whether consisting of one or more entries;
2. Upon an account stated, based upon an account in writing;
3. A balance due upon a mutual, open and current account, provided that where an account stated is based upon an account of one item, the time shall begin to run from the date of said item, and where an account stated is based upon more than one item, the time shall begin to run from the date of the last item.

Within five years. An action for mesne profits (i.e., profits accruing between the time an owner acquires title and actually takes possession). Also, an action for the recovery of real property.

Within ten years. An action upon a judgment or decree of any court of the United States or of any state within the United States.

In connection with the Statute of Limitations, an action is commenced when the complaint is filed with a court of competent jurisdiction.

Remedies for Breach

As a final possibility, a contract may be discharged by simple *acceptance of breach*. If one party fails to perform, the other may accept the contract as ended, concluding either that recoverable damages are too limited to justify litigation or that the other party is “judgment proof” (without sufficient assets to satisfy a judgment).

On the other hand, the victim of a breach of contract may not be willing to accept the breach. That person has a choice of two, and sometimes three, courses of action:

1. Unilateral rescission.
2. Action for dollar damages.
3. Action for specific performance.

Rescission

To rescind because of breach requires diligent compliance with the following statutory rules:

- One must rescind promptly after discovering the facts which justify rescission; and,
- One must restore to the other party everything of value received from the other party under the contract, or must offer restoration upon condition that the other party do likewise, unless the latter is unable or positively refuses to do so.

If a court awards rescission, it may require that the rescinding party make any compensation to the other which justice may require. It should be noted, however, that a party having the right to rescind may independently accomplish a completed rescission, terminating further liability and discharging the contract.

Damages

Whenever a party to a contract is a victim of breach, such party has suffered a detriment and may recover compensation therefor in money, which is called damages. This party is entitled to interest (now 10% per annum) thereon from the day the right to recover is vested. If the contract itself stipulates a legal rate of interest, that rate remains chargeable after the breach as before, and until superseded by a verdict or other new obligation.

Damages for breach of contract must be reasonable, and exemplary damages which serve to punish the defendant are not allowed normally unless a strong showing of bad faith can be made. The measure of damages normally is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which in the ordinary course of things would be likely to result therefrom. Sometimes, when the breach has caused no appreciable detriment, hence no dollar damages, the court will award “nominal damages” (e.g., \$1).

The detriment caused by the breach of an agreement *to convey* an estate in real property is deemed to be the price paid and the expenses properly incurred in examining the title and preparing the necessary papers, with interest thereon. In case of bad faith, added to the above is the difference between the price agreed to be paid and the value of the estate agreed to be conveyed, at the time of the breach, and the expenses properly incurred in preparing to enter upon the land. On the other hand, the detriment caused by the breach of an agreement *to purchase* an estate in real property is deemed to be the excess, if any, of

the amount which would have been due to the seller, under the contract, over the value of the property to the seller.

Sometimes, especially in building contracts, the parties will anticipate the possibility of a breach: e.g., a delay in completion beyond a promised date. The parties may specify in the contract the amount of damage to be paid in the event of the breach. Such *liquidated damage* agreements will be enforced by the courts provided the amount specified is not so excessive as to constitute a penalty, and provided it would be impractical or extremely difficult to fix the actual damage and normally only if the contract expressly provides that liquidated damages shall be the only remedy available in the event of breach of the contract.

Specific Performance

Generally where dollar damages at law cannot provide an adequate remedy, equity will take jurisdiction and order the defendant to perform the contract. (Sometimes, equity may also enforce a promise to forbear from doing something by granting an *injunction*.)

Requirements to compel performance. Specific performance is especially important in the real estate business in connection with contracts for the transfer of interests in land. Since every piece of land is unique, the law presumes that the breach of an agreement to transfer real property cannot be relieved adequately by money compensation. For specific performance to be available as a remedy, however, certain other requirements must normally be met before the court will compel a party to perform a contract.

If specific performance is to be ordered, the remedy must be mutual. However, by statute, even if the agreed counter-performance would not be specifically enforceable, specific performance may be compelled if: (a) specific performance would otherwise be an appropriate remedy, and (b) the agreed counter-performance has been substantially performed or can be assured. Brokers dealing with prospective oil land and oil leases are familiar with a contract provision stating that the lessee may at any time before or after discovery of oil on the property quitclaim the same or any part thereof to the lessor, whereupon the rights and obligations of the parties to the lease shall cease. Such a clause giving the lessee the right to abandon robs the contract of mutuality. It therefore cannot be specifically enforced.

An option for the purchase of real estate where there is a consideration therefor is specifically enforceable although the owner cannot at that time compel its exercise. Neither can the owner withdraw the option during the time agreed upon. Upon the written exercise of the option by the buyer according to its terms, there is then created a contract of sale. It is this contract that gives rise to the remedy of specific performance. It is not uncommon for an optionee or other person who may not have signed a contract to bring suit thereon for its specific performance. The fact that the party brings such a suit establishes mutuality, because by it one subjects oneself to and agrees to abide by the decree of the court.

Obligations which cannot be specifically enforced. By statute, the following obligations cannot be specifically enforced: (1) to render personal service; (2) to employ another in personal service; (3) to perform an act which the party has not power lawfully to perform when required to do so; (4) to procure the consent of any third person; and (5) an agreement the terms of which are not sufficiently certain to make the precise act which is to be done clearly ascertainable.

Thus husband and wife must join in executing any instrument by which community real property or any interest therein is sold, conveyed, or encumbered, or is leased for a longer

period than one year.

Note: The right of a purchaser in good faith without knowledge of the marriage relation where one spouse alone holds the record title to the real property may be established without the other spouse's signature.

Since an agreement to procure the consent of a spouse or any third person cannot be specifically enforced, it is exceedingly important to get the signature of the other spouse. In fact, the signatures of both spouses to any contract relating to community real property should be secured.

Frequently this failure to procure the signature of the other spouse is cured by the seller putting into escrow the deed signed by both husband and wife or by the buyer putting into escrow a deed of trust signed by both. Where that is done the original want of mutuality is cured, provided it is done before an attempt is made to withdraw from the contract by the other party. It is not wise to rely upon this possibility, or even probability. The alert real estate broker will in the beginning obtain the signatures of all parties.

It is not uncommon that there are two owners to property other than husband and wife. It is therefore necessary to get the signatures of all of the owners because the buyer could not compel specific performance of the contract as to one-half of the property where it is contemplated that the whole is to be sold.

Adequate consideration — assent by fraud — merchantable title. Specific performance cannot be enforced against a party to a contract if such party has not received adequate consideration. This doctrine does not require that the highest price obtainable must be procured. It means that a price that is fair and reasonable under the circumstances must be obtained. If a higher price is offered during the negotiations, it must be presented.

Thus in one California case the broker signed up a buyer at \$30,000, knowing that \$35,000 had been offered for the property. Inadequacy was held to defeat the buyer's suit in specific performance. The court also called attention to the law which requires perfect good faith on the part of agents, not only in form but in substance.

Furthermore, to entitle plaintiff to use the equitable remedy of specific performance, he or she must show that the contract as to the defendant is just and reasonable. The court denied specific performance in one case because the seller was not given adequate security to insure the payment of the balance of the price.

Specific performance cannot be enforced against a party to a contract if his or her assent was obtained by misrepresentation, concealment, circumvention, or unfair practices of any party to whom performance would become due under the contract, or by any promise of such party which has not been substantially fulfilled. This is likewise true if such assent was given under the influence of mistake, misapprehension, or surprise.

Note: Where the contract provides for compensation in case of mistake, the mistake, if correctable, may be compensated for, and the contract specifically enforced in other respects.

A buyer is always entitled to receive a merchantable title. Therefore, if the seller cannot give the buyer a title free from reasonable doubt, the seller cannot specifically enforce such an agreement. This does not mean title need be merchantable at the time the original agreement was executed, but at the time it becomes the duty of the seller to convey. If there are encumbrances known to the parties, subject to which it is agreed the title will be conveyed, these encumbrances should be described in the contract and will not block

specific performance.

REAL ESTATE CONTRACTS

Real estate contracts include: (1) contracts for the sale of real property or of an interest therein; (2) agreements for leasing of realty for a longer period than one year; and (3) agreements authorizing or employing an agent or broker to buy or sell real estate for compensation or a commission.

These contracts are essentially like any other contract except that they must be in writing and must be signed by the party to be charged to make them valid under the Statute of Frauds. Thus as we have seen in the discussion on contracts in general, there must be: (1) *parties capable of contracting*; (2) *their consent (i.e., genuine offer and acceptance)*; (3) *a lawful object*; and (4) *sufficient consideration*.

In the usual real estate sales transaction, the prospective buyer states the terms and conditions under which the buyer is willing to purchase the property. These terms and conditions constitute the offer. If the owner of the property agrees to all of the terms and conditions of the offer it is an acceptance which results in the creation of a contract. It makes no difference whether the offer comes from the seller or the buyer; if the negotiation finally leads to a definite offer on the one side and unconditional acceptance on the other side, a contract has been effected. All that is legally required to complete the contract for the sale of real property is to reduce the terms and conditions to writing, and to have the parties sign the contract.

Provisions in Contracts

Forms such as listing agreements (authorization to sell), deposit receipts, exchange agreements, and other real estate contracts for the sale or exchange of real estate should contain the following provisions:

1. The date of the agreement;
2. The names and addresses of the parties to the contract;
3. A description of the property;
4. The consideration;
5. Reference to creation of new mortgages (or trust deeds) and the terms thereof; the terms and conditions of existing mortgages, if any;
6. Any other provisions which may be required or requested by either of the parties;
7. The date and place of closing the contract.

A contract of sale normally calls for the preparation of a deed to convey the property. It is executory in that when the deed is properly *signed and delivered* to the purchaser the contract is executed.

Handling deposit on property in a sale. *An earnest money deposit by a prospective purchaser of real property is trust funds.* The deposit must be handled by the broker as prescribed by the Real Estate Law and the regulations.

Section 10145 of the Real Estate Law provides that the broker who receives trust funds must place the funds into a trust fund account in a bank or other recognized depository if the broker does not place the funds into a neutral escrow or into the hands of the broker's principal.

The regulations of the Commissioner spell out the procedures to be followed by a broker who elects to hold the funds uncashed or place the earnest money deposit into broker's trust fund account until acceptance. The contract usually provides that upon acceptance, the deposit will be immediately placed into an independent escrow or title company.

The provision of law which purports to sanction the handing over of all varieties of trust funds to a principal by the broker poses some real dilemmas for brokers when the trust funds in question are in the form of deposits toward purchase. The problems for the broker are particularly troublesome in those transactions where there has been an alleged breach by the buyer of what appears to be a binding contract to purchase the real property. Since the law apparently permits a broker to hand over an earnest money deposit to the seller as soon as there has been an acceptance of the offer to purchase, unless the terms of the contract provide otherwise, can the broker who has the money in his or her trust fund account refuse to turn it over to the seller upon demand when the seller concludes that the buyer has breached the contract?

There is no legal authority that provides a clear-cut answer to this question. There are those knowledgeable of the Real Estate Law in California who contend that the broker holds the earnest money deposit after an apparent acceptance of the contract as an escrow holder rather than as an agent of the seller. While the Department does not accept this proposition, it does recognize that the broker is in a very difficult position when a transaction falls apart and either or both parties make demand for the earnest money. To avoid having to make a decision as to who is entitled to an earnest money deposit and later possibly be held liable or subject to disciplinary action for having made the wrong choice, the broker is probably well advised to file an interpleader action and deposit the funds with the court in which the action is brought. If, as noted above, the trust funds have already been placed into an independent escrow upon acceptance, the funds may be held there pending resolution of the dispute.

Forfeitures. Contracts for the sale of real property frequently include a provision that a deposit toward purchase made by a prospective buyer shall be divided between the seller and the broker if the prospective buyer breaches the contract through no fault of the seller or broker. Such provisions for the forfeiture of the deposit by the buyer in case of breach come within the definition of liquidated damages clauses.

If the contract is for the purchase and sale of residential real property, defined as a dwelling of not more than four residential units and the buyer intends to occupy the dwelling or one of the units as a residence, the following rules apply:

1. These special rules apply only to amounts actually prepaid, in the form of deposit, downpayment, or otherwise.
2. If the amount paid pursuant to the liquidated damages clause does not exceed 3% of the purchase price, the clause is valid unless the buyer proves that the amount paid is unreasonable.

3. If the amount actually paid pursuant to the liquidated damages clause exceeds 3% of the purchase price, the clause is invalid unless the party seeking to enforce it proves that the amount paid is reasonable.
4. The provision must be separately signed or initialed by each party to the contract, and if it is a printed contract, the provision must be set off in ten point bold type or contrasting red print in eight point type.

These rules do not apply to real property sales contracts, as defined in Civil Code Section 2985.

Effect of seller's death on real estate contract. If the contract is entered into for the sale or purchase of real estate, and before the time of taking title the seller dies, a real problem ensues. A real estate contract properly drawn usually contains a provision which states that all the terms of the contract are to be binding upon the heirs, executors, administrators, and the assigns of the respective parties.

In the event this wording is used, the buyer's rights are the same against the heirs, executors, administrators, or assigns of the seller as the buyer had against the seller. Under these circumstances buyer may compel the seller's heirs, administrators, executors, or assigns specifically to perform the contract.

Uniform Vendor and Purchaser Risk Act (Civil Code Section 1662). Occasionally, after a contract is made for the purchase and sale of real property, a fire or other disaster destroys or seriously damages the property. Who shall take the loss? Under California's Uniform Vendor and Purchaser Risk Act, any contract made in this state for the purchase and sale of real property shall be interpreted as including an agreement that the parties shall have the following rights and duties unless the contract expressly provides otherwise:

1. If, when neither the legal title nor the possession of the subject matter of the contract has been transferred, all or a material part thereof is destroyed without fault of the purchaser or is taken by eminent domain, the seller cannot enforce the contract, and the purchaser is entitled to recover any portion of the price paid;
2. If, when either the legal title or the possession of the subject matter of the contract has been transferred, all or any part thereof is destroyed without fault of the seller or is taken by eminent domain, the purchaser is not thereby relieved from a duty to pay the price, nor entitled to recover any portion thereof that has been paid.

Options

Since an option is a form of contract, the requirements for the enforceability of real estate contracts in general apply. Some consideration, even though it might be only 25¢ on a \$100,000 parcel of real estate, must in fact pass from optionee to optionor. A mere recital of consideration alone is insufficient. Provisions of a lease, however, are themselves sufficient consideration to support an option contained in it. Option contracts typically "run from" seller to buyer. That is, in exchange for consideration paid by the buyer, the seller is deprived of the right and power to revoke the basic offer to sell. The buyer, in effect, purchases an agreed amount of time in which to accept or reject the seller's underlying offer concerning the property. Thus, the underlying offer is rendered irrevocable for the period specified in the collateral option contract.

Although option rights are usually assignable unless there is a restriction to the contrary, they do not give the optionee any "interest in the land." For this reason, the optionee cannot "mortgage" his or her rights. The holder of an unexercised option does however

have an interest for which the holder may be entitled to compensation on condemnation of the land.

The option may be given either alone or in connection with a lease of the property. It may be in either the customary form of an exclusive right to purchase or lease, or in the form of a privilege of first right of refusal to purchase or lease. The option will terminate automatically upon expiration of the time specified without “exercise” by the optionee. Additionally, the termination of a lease containing an option also usually terminates the option. A renewal of the lease may, however, renew the option. The specific lease situation must sometimes be carefully examined, since the option provisions and the lease provisions may be divisible.

An option to purchase real property is a written agreement whereby the owner of real property agrees with the prospective buyer, that such buyer shall have the right to purchase the property from the owner at a fixed price within a certain time. Terms of financing, payments, etc., should be set forth in such agreement. The prospective buyer at buyer’s option may comply with all the terms of the agreement or be relieved from the terms of the agreement without the owner having recourse to legal procedure for damages or specific performance. The option does not bind the optionee to any performance. It merely gives the optionee a right to demand performance. Time is of the essence in an option and is usually strictly construed. If no time is specified, a reasonable time is implied.

In the event an option is recorded by the optionee, but is not exercised before or on the date of the expiration of the option, the optionee should remove the effect of the option from the records by recording a quitclaim deed.

The broker usually does not earn a commission for having secured a client who takes an option, as the broker’s right of commission does not arise unless the option is exercised.

Listing Defined

A listing is a written contract by which a principal employs an agent to do certain things (e.g., sell real property) for the principal. Therefore an agent holding a listing is always bound by the law of agency and has certain fiduciary obligations to the principal that do not exist between two principals.

Net listing. In a net listing the compensation is not definitely determined, but a clause in the contract usually permits the agent to retain as compensation all the money received in excess of the selling price accepted by the seller. Under the Real Estate Law failure of an agent to disclose the amount of agent’s compensation in connection with a net listing is cause for revocation or suspension of license. This must be done prior to or at the time the principal binds himself or herself to the transaction. The agent is also required by the Real Estate Law to reveal to both buyer and seller, in writing within one month of the closing of the transaction, the selling price involved. The law permits this information to be disclosed by the closing statement of the escrow holder, and this is the usual practice.

A net listing is perfectly legitimate, but it may give rise to a charge of fraud, misrepresentation and other abuses. Accordingly, if a net listing is used, the commission arrangement should be thoroughly explained to the principal.

Open listing. An open listing is a written memorandum signed by the party to be charged (usually the seller of the property) which authorizes the broker to act as agent for the sale of certain described property. Usually no time limit is specified for the employment, although open listings can provide for a definite term. The property is identified by a suitable description, and generally the terms and conditions of sale are set forth.

Open listings are the simplest form of written authorization to sell. They may be given concurrently to more than one agent, and usually the seller is not required to notify the other agents in case of a sale by one of them in order to prevent liability of paying more than one commission. Where several open listings are given, the commission is considered to be earned by the broker who first finds a buyer who meets the terms of the listing, or whose offer is accepted by the seller. If the owner personally sells the property, the owner is not obligated to pay a commission to any of the brokers holding open listings. The sale of the property under such an agreement is considered to cancel all outstanding open listings.

Exclusive agency listing. An exclusive agency listing is a contract containing the words “exclusive agency.” The commission is payable to the broker named in the contract and if the broker or any other broker finds the buyer and effects the sale, the broker holding the exclusive listing is entitled to a commission.

If a broker other than the broker holding the exclusive agency listing is the procuring cause of the sale, the owner may be liable for the payment of two full commissions if the procuring broker has some type of written agreement with the seller. Because the listing refers to an *agency* and the owner is not an agent, the owner may personally effect the sale without incurring liability for commission to the broker holding the exclusive agency listing.

Exclusive right to sell listing. Another form of listing is the “exclusive right to sell.” Under such listing, a commission is due the broker named in the contract if the property is sold within the time limit by the said broker, by any other broker, or by the owner. Frequently, this listing also provides that the owner will be liable for a commission if a sale is made within a specified time after the listing expires to a buyer introduced to the owner by the listing broker during the term of the listing. The real estate broker is usually obligated under the terms of the listing contract to furnish a list of the names of persons with whom the broker has negotiated during the listing period within a specified number of days after the expiration of the listing.

The “exclusive right” and the “exclusive agency” type of listing must be for a definite term, with a specified time of termination. If a broker does not provide for this, the broker’s license is subject to disciplinary action under the California Real Estate Law.

Multiple listing service. A multiple listing service is a cooperative listing service conducted by a group of brokers, usually members of a real estate board. The group provides a standard “multiple listing” form which is used by the members. It is usually an “Exclusive Authorization Right to Sell” listing form and provides, among other things, that the member of the group who takes the particular listing is to turn it in to a central bureau. From there it is distributed to all participants in the service and all have the right to work on it. Commissions earned on such listings are shared between the cooperating brokers, with the listing broker providing for the division of commission in each listing sent to other participants.

When broker is entitled to commission. Ordinarily the broker is entitled to a commission when the broker produces a buyer ready, willing and able to purchase the property for the price and on the terms specified by the principal, regardless of whether the sale is ever consummated. Contracts may expressly provide that no commissions are payable except on a completed sale or on an installment of the purchase price when paid by the buyer, and such a provision controls in the absence of fraud or prevention of performance by the principal. The broker must be the procuring cause of the sale. It is not sufficient that the broker merely introduces the seller and buyer, if they are unable to

agree on the terms of the sale within the time period of the agency.

The broker may, however, have a cause of action for the payment of commission if, within a specified time after expiration of the listing, the property is sold to a buyer introduced by the broker during the term of the listing contract.

Deposit Receipt

California brokers use a deposit receipt when accepting earnest money with an offer to purchase real property. This is a receipt for the money deposited and, more importantly, the basic contract for the transaction. It should set forth all the basic factors which are included in a contract of sale, including arrangements for financing. It should contain a complete understanding among the buyer, seller, and broker as to the return of the deposit in the event the offer is not accepted, and provisions for disposition of deposit money should the buyer fail to complete the purchase.

Some of these provisions are incorporated by standard clauses in the deposit receipt forms. The terms and conditions written into the offer must be done with extreme care by the broker or salesperson.

Agent must give copies of contracts. The real estate license law provides that brokers and salespersons must give copies of documents and agreements to the persons signing them at the time the signature is obtained. The law not only applies to copies of listing contracts and deposit receipts, but to any document pertaining to any of the acts for which one is required to hold a real estate license.

Tender Defined

A tender in a real estate transaction is an offer by one of the parties to the contract to carry out that party's part of the contract. A tender is usually made at the time for closing of escrow (i.e., concluding the transaction). If one of the parties defaults or is unable to carry out his or her contractual obligation, the other party makes the tender. (If the seller, an offer of the deed and a demand for payment of the balance of the purchase price. If the purchaser is ready, an offer of the money required and demand for the deed.) In the event of litigation arising out of some dispute between the buyer and the seller, the party who made the tender can rightfully claim that he or she was ready, willing and able to go through with the deal, and that the other party defaulted. If both parties were in default, neither may recover any damages from the other. Whether the parties made a tender is a question of fact which must be established by competent evidence.

The person to whom the tender is made must specify any objections at the time or they are waived. The tender of performance, when properly made, has the effect of placing the other party in default if the other party refuses to accept it and the party making the tender may rescind or sue for breach of contract or for specific performance.

ACQUISITION AND TRANSFER OF REAL ESTATE

Usually, acquisition of property by one party entails a transfer from another party, and so we consider acquisition and transfer together.

The basic distinction between real and personal property is not taken into account in the broad statutory statement of how "property" is acquired. In the following discussion, however, the methods by which real property is acquired or transferred are emphasized.

The Civil Code states that there are five ways to acquire property: will, succession, accession, occupancy, and by transfer as follows:

1. By will:

- a. Formal or witnessed will.
 - b. Holographic will.
 - c. California Statutory will.
 - d. California Statutory will with Trust.
2. By succession:
 - a. Of separate property.
 - b. Of community property.
 3. By accession:
 - a. Through accretion (alluvion or reliction).
 - b. Through avulsion.
 - c. Through addition of fixtures.
 - d. Through improvements made in error.
 4. By occupancy:
 - a. Abandonment.
 - b. Prescription.
 - c. Adverse possession.
 5. By transfer:
 - a. Private grant.
 - b. Public grant.
 - c. Gift (to private person or to public, by dedication).
 - d. Alienation by operation of law or court action (partition, quiet title, foreclosure, declaratory relief).
 6. By marriage.
 7. By escheat.
 8. By eminent domain.
 9. By equitable estoppel.

Will

Property accumulated during life may be disposed of at death to designated beneficiaries. The instrument to achieve this disposition of property is called a will. The execution of a will during life has no effect on property interests; the instrument only becomes effective at death. This is the distinguishing feature between wills and other instruments creating property interests such as deeds and contracts. The latter two instruments create some present interest and are not dependent upon the fact of death to be effective.

Types of wills. The types of wills permitted by law are the *witnessed will*, *holographic will*, *statutory will* and *statutory will with trust*. The first is a formal written instrument signed by the maker and declared to be the maker's will in the presence of at least two witnesses who, at the maker's request and in the maker's presence, also sign the will as witnesses. This document should be prepared by an attorney. A holographic will is one entirely written, dated and signed in the testator's own handwriting. No other formalities are required. Statutory wills are prepared in accordance with a format authorized by

statute.

When a person dies, title to his or her real property passes directly to the beneficiaries named in the will, or to the heirs if the decedent left no will. Title, however, is not marketable or insurable because the law provides that on death all property is subject to the temporary possession of the executor or executrix, administrator or administratrix, with a few exceptions. Legal title is also subject to the control of the probate court for purposes of determining and liquidating creditors' claims and for establishing the identity of the heirs, devisees, and legatees of the estate.

Probate

Probate procedure commences with a "petition for probate" of a will or for letters of administration if there is no will. A hearing is held and a representative is appointed to handle the estate. This person is referred to as an executor or executrix if there is a will or an administrator or administratrix if there is no will or if no personal representative is named in the will.

Notice to creditors is then published, giving all creditors four months within which to file their claims. An inventory and appraisal of the estate listing all the assets is filed with the county clerk. During administration of the estate, the representative may sell estate property subject to court approval only.

After the time for filing creditors claims has expired, the representative files an accounting of all receipts and disbursements and requests court approval of same. Finally, the representative petitions the court to approve distribution of the remaining assets to the proper heirs and devisees. Small estates may be exempt from probate administration or subject to special summary procedures.

Succession

If a person dies without leaving a will, the law provides for disposition of decedent's property. This is called *intestate succession*. A large number of special rules are included in the law depending upon the character of the property and the relationship of the next of kin. In the simplest cases, *separate* property is divided equally between a surviving spouse and one child, or split one-third to the surviving spouse and one-third to each of two children, etc. One-half of the *community* property belongs to the surviving spouse and the other half is subject to disposition by the decedent's will. If there is no will, the decedent's half of the community property remaining after payment of his or her liabilities goes to the surviving spouse.

Accession

By accession, an owner's title to improvements or additions to his/her property may be extended as a result of either man-made or natural causes. For example, a fixture may be annexed to a building by a tenant, or a neighbor may affix a wall or a building in such a way to the landowner's property without agreement to remove the improvement so as to extend the landowner's title to the improvement.

By natural causes, through *accretion*, the owner of a riparian property (i.e., located along a moving body of water such as a river or stream) or littoral property (located beside a pond, lake or ocean) may acquire title to additional land by the gradual accumulation of land deposited on the owner's property from the shifting of the river or the ocean's action. The land increase by this build-up of sediment (or alluvium) is called *alluvion*. The gradual recession of water, leaving permanently dry land is *accession* caused by *reliction*. Rapid washing away of land is called *avulsion*.

Addition of fixtures. Acquisition of title by addition of fixtures occurs when a person

affixes something to the land of another without permission and/or an agreement permitting removal of it. The thing so affixed belongs to the owner of the land, unless the owner requires the former tenant to remove it.

Improvements made in error. At one time there was no compensation for the innocent person who mistakenly improved someone else's real property (e.g., built a house on another's lot). However, the Legislature changed this in 1953 by amendment of Civil Code Section 1013.5. The change permits a person who affixes improvements to the land of another in good faith and erroneously believing because of a mistake of fact or law that he or she has a right to do so to remove the improvements upon payment of damages to the owner of the land and any other persons having an interest therein who acquired the interest in reliance on the improvements.

Abandonment. Abandonment is the voluntary surrender of possession of real property or a leasehold with the intention of terminating one's possession or interest and without assigning the interest to another. If the owner of a leasehold interest (i.e., the lessee) abandons the property, the landlord reacquires possession and full control of the premises. Mere non-use is not abandonment.

Prescription. An easement created by prescription is analogous to adverse possession. Although only the right to use someone else's land results, a property interest is thus acquired.

Adverse possession. The actual physical possession of property has always been accorded considerable weight in connection with a variety of rights and obligations. Immediately upon occupying property, an adverse possessor acquires a title to the property good against all the rest of the world except the state and the true owner. Such occupation may ripen into *legal* title by adverse possession if the possession is:

1. by actual occupation;
2. open and notorious;
3. hostile to the true owner's title;
4. under claim of right or color of title;
5. continuous and uninterrupted for a period of five years;
6. accompanied by payment of all real property taxes for a period of five years.

Since title by adverse possession cannot be traced from the county recorder's office, it is neither marketable nor insurable until perfected by court decree.

Title by adverse possession cannot usually be acquired against a public body.

Transfer

Property is acquired by transfer when, by an act of the owner or of law, title to property is conveyed from one person to another. It is the variations of transfer which are of primary concern to real estate brokers.

Private grant. Conveyancing, for consideration, of title to real property by private grant is very important to a real estate broker and is discussed in Chapter 7.

Gift. An owner of property may voluntarily transfer it to another person without demanding or receiving consideration. If the gift is real property, it would normally be

conveyed by a deed.

Public dedication. Real property intended for public use can be acquired by a governmental body for such use in any one of three ways: common law dedication, statutory dedication, and deed.

Common law dedication requires that the landowner's conduct evidence an intent to devote the land to some public use, as by executing a deed describing a boundary as being a "street." To be effective, the public must accept this dedication by local ordinance or by public use.

The most common example of statutory dedication takes place under the Subdivision Map Act when a landowner records a map on which certain areas are expressly dedicated to the public for streets and parks, etc.

Dedication by deed is generally used in specific situations not involving subdivisions created under the Subdivision Map Act. Usually, only an easement is transferred. However, many local governments now require deeds so that fee title, rather than an easement, is acquired. This method avoids title problems arising upon abandonment.

Alienation by court action. There are a variety of situations in which courts establish legal title regardless of the desires of the record owners.

Any person may sue another who claims an adverse interest in real property. This type of proceeding is called a *quiet-title action* and is the usual way of clearing tax titles, titles based upon adverse possession and the title of a seller under a forfeited recorded contract of sale.

A co-owner of property may sue the other co-owners, requesting a severance of the respective interests. If the property cannot practically be divided physically, as is usually the case, the court may order a sale, transfer title to the buyer, and divide the proceeds among the former owners. This proceeding is called a *partition action*.

A person holding a lien based upon contractual delinquency may ask that the court order sale of the property, transfer of title to the purchaser, and application of the sales proceeds to the unpaid balance due under the contract. This is called a *foreclosure action*. Mortgage and mechanic's lien foreclosures are examples.

A person may, in cases of actual controversy, bring an action to determine his/her rights and obligations under any written instrument. A judicial declaration of rights in advance of an actual tortious incident enables the parties to shape their conduct so as to avoid a breach. This *declaratory relief action* is often used to construe deeds, restrictions or homesteads, or to determine rights under an oral contract.

Execution sale. A plaintiff in an action who obtains a money judgment against a defendant can take appropriate steps to get a *writ of execution*. This court order directs the sheriff (or marshal or constable) to satisfy the judgment out of property of the debtor. Real property belonging to the debtor, and not exempt from execution, is seized by the officer and sold at public auction.

The buyer receives a certificate of sale and, if no redemption is made within the time allowed by statute (usually 12 months), the officer executes and delivers a deed to the buyer.

Forfeiture. An owner may impose a *condition subsequent* in a deed. If the condition is breached, the grantor or grantor's successor has the power to terminate the estate and reacquire title. Similarly, the owner may impose a *special limitation* in a deed. If the

stated event occurs or the prescribed status fails to endure, the estate automatically terminates and the grantor or his or her successor reacquires title. In both cases, property is acquired by forfeiture with no need for consideration.

Marriage. Under California law, marriage does not effect a transfer of title to property. However, *subsequent* earnings and acquisitions of husband and wife, or either, during marriage, when not acquired as separate property, are *community property*. Each spouse has a present, existing and equal interest in such property.

Escheat. Escheat is the legal process by which title to property vests in the state, usually for lack of heirs or want of legal ownership. Since a presumption exists that some heirs capable of taking title exist in every case, the process of escheat is not automatic. Escheat proceedings can be based on an action initiated by the Attorney General or on a decree of distribution by a probate court.

Eminent domain. By eminent domain, a governmental entity takes private property for public use, paying compensation based on fair market value.

Equitable estoppel. Equity and good conscience sometimes require that title to real property be transferred if justice is to be done. The former owner is barred or estopped from denying the title of the innocent claimant.

For example, if an owner permits a friend to appear to the world as the owner of certain property, and an innocent third party buys the land from that apparent owner, the true owner is barred by the doctrine of equitable estoppel from claiming ownership.

Similarly, if a person has no title, or a defective title or an estate smaller than the one purported to be conveyed, but later acquires full title or estate, or perfects the title, the grantee (or grantee's successor) gets the after-acquired title by way of estoppel.

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