

INSPECTION CONTINGENCY CLAUSES AND CONTRACT LAW

I. INTRODUCTION

REALTORS® continue to try to cope with questions regarding inspection contingency clauses. What if the deadline for an inspection passes and the buyer remains silent? Has the buyer waived the contingency or is the contract null and void? What if after the inspection, the buyer presents a proposed addendum asking the seller to agree to make certain repairs? If the buyer's proposal is rejected by the seller, is the purchase contract terminated or does the purchaser have the option of proceeding under the terms of the original purchase contract?

As will be discussed below, the answers to these questions depend on the language of the specific inspection contingency clause. Prior to discussing the intricacies of inspection clauses, however, it may be helpful to review the law of counteroffers and amendments generally.

II. DISCUSSION

A. Counteroffers and Amendments: A Refresher

Buyers and sellers are often confused by the intricacies of contract law. In many transactions, offers, counteroffers, addendums and amendments fly back and forth leaving the parties (and their REALTORS®) uncertain as to their rights and obligations. As an aside, in common parlance, the terms "addendum" and "amendment" are used interchangeably and REALTORS® should attach no particular significance to the choice of either term.

1. Offer and Acceptance

A seller who receives an offer can accept, reject or counter that offer. In addition, the seller can simply do nothing. A buyer can request that the seller respond to his offer in writing, however, the seller has no legal obligation to do so.

An offer remains open until one of the following occurs: (1) the offer automatically expires at a specific time and date set forth in the offer; (2) the offer is revoked; (3) the offer is rejected or countered; or (4) the offer is accepted.

Generally, an offer can be revoked at any time before it is accepted by the seller. A revocation does not need to be in writing. Even if the offer has a stated expiration date, the Michigan Supreme Court has held that in the absence of a payment or other consideration, an offer can be revoked prior to its stated expiration date. *Hollingshead v Morris*, 172 Mich 126 (1912).

A counteroffer is deemed a rejection of the offer and itself becomes an offer. Sellers cannot simultaneously “accept” and materially modify an offer. Once an offer is rejected or countered, it cannot be accepted. So, for example, if a seller presents a counteroffer, and the buyer rejects the seller’s counteroffer, the seller cannot resurrect and accept the buyer’s original offer. A seller with two (or more) counteroffers outstanding runs the risk that both will be accepted and then the seller will be contractually obligated to sell the property to two different buyers.

An acceptance involves a signature and the communication of that fact. Unless the contract expressly provides otherwise, this “communication” must be in the form of delivery of

the signed acceptance. Typically, you cannot create a binding contract by orally communicating the fact that the acceptance has been signed. Delivery of the acceptance can be to the offeror or his agent. Whether delivery of the seller's acceptance to the cooperating agent is effective depends on who that cooperating agent represents.

Remember, a person cannot orally authorize someone else to sign a real estate contract on that person's behalf. A party's faxed signature should be sufficient, particularly if the contract includes a clause permitting faxed signatures.

A "bottom line" signature is not necessary for a binding contract. A "bottom line" signature serves only as written verification that the signed purchase agreement has, in fact, been provided to the buyer as required under the rules promulgated under the Occupational Code. R 339.22307. Even if a buyer refuses to sign the "bottom line" of a purchase agreement, it is nonetheless a contract.

2. Amendments

Once the parties have entered into a valid and binding contract, either party may, at any time, propose an amendment to that contract. A party is under no obligation to accept a proposed amendment; however, once accepted, it becomes a binding portion of the original agreement. Where there is a conflict between the terms of a contract and a subsequent amendment to that contract, the latter document controls.

A seller who receives a proposed amendment can accept, reject or counter that amendment. Or the seller can do nothing. If the seller rejects a buyer's proposed amendment (or does nothing), the original contract stands "as is." A seller cannot use the

fact that the buyer has proposed an amendment to a contract to get out of the original contract.

There is often confusion among buyers and sellers as to what is a proposed amendment to a purchase agreement and what is a counteroffer. Assume for example, the seller and buyer have entered into a purchase agreement. Based on some subsequent event, the buyer submits an addendum to the seller which proposes some change to the terms of the existing contract say, for example, a delayed closing or an earlier possession date. The proposed amendment by the buyer is not a counteroffer. There cannot be a counteroffer to an existing binding purchase agreement. Instead, the addendum is simply an invitation from the buyer to amend the purchase agreement. The seller's refusal to accept the invitation to amend the purchase agreement does not terminate the purchase agreement.

B. Inspection Contingency Clauses

The application of the law of counteroffers and amendments can become particularly confusing as it relates to inspection contingency clauses. This article will address some of the most common issues that arise by looking at a number of different types of inspection contingency clauses and applying different hypothetical scenarios.

In the first hypothetical, consider the following clause:

Sample Clause 1: The Buyer's offer is subject to a satisfactory inspection within ten (10) days.

Assume that REALTOR® Jones has listed the Smith property for \$100,000. The Browns submit an offer on their property for \$95,000, which is accepted by the Smiths. The offer is subject to the "Sample Clause 1" inspection contingency. Assume that the ten-day period

expires without any further communication between the parties. Have the Browns waived the inspection contingency or is the contract null and void?

As is the case with "Sample Clause 1," too often, an inspection contingency clause does not indicate anything other than the time period provided for the inspection. The legal question is whether the buyers, the Browns, by their silence, have waived their right to terminate the transaction. There is no Michigan case directly on point on this issue and, thus, it is difficult to predict how a court would look at this situation. REALTORS® can avoid this uncertainty by using a more carefully worded inspection contingency clause. An inspection clause should indicate that if the buyer fails to provide notice regarding the inspection, then such silence will result in the inspection contingency being deemed waived or, alternatively, that silence will result in the buy/sell agreement being deemed terminated by the buyers:

Sample Clause 2: The Buyer's offer is subject to a satisfactory inspection within ten (10) days. If Buyer is not satisfied with the results of this inspection, Buyer may terminate this contract by providing written notice to Seller within this period. Failure to provide such timely notice shall constitute a waiver of this contingency.

OR

Sample Clause 3: The Buyer's offer is subject to a satisfactory inspection within ten (10) days. If Buyer does not waive this contingency in writing prior to the expiration of this inspection period, this contract shall be deemed null and void.

In the next hypothetical, assume that the Browns obtain an inspection in a timely manner and after learning that the roof needs repair at an estimated cost of \$1,900, they

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provide a proposed addendum to the Smiths indicating that the Browns will proceed with the transaction if they receive a credit against the purchase price for \$1,900; or, alternatively, that the Browns will proceed with the purchase for \$95,000 if the Smiths have the roof repaired to the Browns' satisfaction prior to closing. What is the status of the purchase agreement between the Smiths and the Browns? If the Smiths don't agree, do the Browns have the option of proceeding with the sale for \$95,000?

As discussed previously, generally, if an addendum is proposed and rejected, the buy/sell agreement remains in full force and effect. Whether the Browns' request that the Smiths repair the roof will be deemed a proposed addendum will likely depend on the language of the original inspection clause, the language used in the Browns' request and the timing of the request. If, for example, the inspection clause provides that the buyers' failure to waive the contingency within the time period shall render the contract null and void ("Sample Clause 3") and the inspection period has run, then a court is likely to conclude that the Browns cannot unilaterally resurrect the purchase contract if the Smiths reject the Browns' proposed addendum. If, on the other hand, the inspection clause provides that the buyer must provide written notice within the time period or will be deemed to have waived the contingency ("Sample Clause 2"), and the Browns are within the ten-day period, the Browns may be able to enforce the original contract if the Smiths reject the Browns' proposed addendum.

With either "Sample Clause 2" or "Sample Clause 3," the Browns may be able to preserve their right to enforce the original contract if they carefully word their request so that it

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is clear that it is a proposed addendum, rather than a termination of the original buy/sell agreement. The practical problem with this approach is that such language is likely to put the Smiths on notice that the Browns intend to buy their home even if the Smiths do not agree to repair the roof.

In an effort to avoid this situation, at the outset, REALTORS® may wish to consider using an inspection contingency clause that anticipates this situation. For example, assume that REALTOR® Jones wants to put the Smiths in a position where they can proceed forward immediately with another offer on the property if the Browns do not obtain a completely satisfactory inspection. The inspection contingency could be drafted as follows to make certain that this can happen:

Sample Clause 4: The Buyers' offer is contingent upon satisfactory inspection within ten (10) days. This contingency shall be deemed waived unless the Buyers object in writing within the time period permitted for the inspection. In the event the Buyers request a modification to the Agreement based upon the results of an inspection, Sellers may either agree to such modification or declare this Agreement null and void.

"Sample Clause 4" in effect requires a buyer to decide whether a particular defect is in fact a deal-breaker before he requests that the seller fix the problem.

Alternatively, suppose that REALTOR® Davis, representing the Browns, wants to make certain that the Browns have the option of requesting that the Smiths make certain repairs while maintaining control over the termination of the contract. The inspection contingency could be drafted as follows to make certain that this can happen:

Sample Clause 5: The Buyers' offer is contingent upon a satisfactory inspection within ten (10) days. Upon receipt of the results of such inspection, the Buyers may request in writing at any time within that ten (10) day period that the Sellers make certain repairs or that the Sellers reduce the sales price to compensate for such defect(s). Such a request to repair or reduce the price does not terminate the contract and the Sellers shall have _____ days from receipt of such request to agree to make such repairs or reduce the sales price. If the Sellers do not agree, the Buyers shall have _____ days to waive the contingency and accept the property "as-is" or to declare the contract null and void. Failure of the Buyers to respond in writing within the time periods set forth above shall constitute a waiver of the contingency.

Under "Sample Clause 5," the Browns can request that the Smiths make certain repairs while still maintaining the right to proceed forward with the contract if the Smiths decline to do so. By providing for this possibility at the outset, the Browns can request that the Smiths make repairs without disclosing the fact that they will close even if the Smiths do not agree to make the repairs.

III. CONCLUSION

REALTORS® should keep in mind that there is no uniform law governing how inspection clauses work; rather, the "rules" depend on the specific language of the particular inspection clause. All inspection contingency clauses are not the same. For example, sometimes silence on the part of the buyer can result in a waiver of the contingency; other times, a buyer's silence can result in the automatic termination of the purchase agreement. Sometimes a buyer can freely request that the seller make repairs; other times by simply making such a request, the buyer is authorizing the seller to elect to terminate the purchase

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contract. When faced with an unfamiliar purchase agreement form, REALTORS® should never assume that the inspection should be handled in the same way that they are accustomed to handling inspections. REALTORS® should always review the specific language carefully before taking any action with regard to the inspection and if there are questions, to seek the assistance of counsel.