OVERVIEW OF BASIC CONTRACT PRINCIPLES

I. INTRODUCTION

REALTORS® must have a solid understanding of basic contract principles in order to assist their clients and customers and to make a living buying and selling real estate. While the means and methods by which REALTORS® carry out their business are changing on what seems to be a daily basis, the foundation for buying and selling real estate and contract real estate law remains carved in granite. REALTORS® are cautioned, however, not to use this information to offer legal advice when contract issues arise. When significant issues arise as to the interpretation or enforcement of a contract, REALTORS® should advise their clients to consult with an attorney.

II. DISCUSSION

The negotiation and formation of purchase agreements is often the source of conflict and misunderstanding. This article is intended to provide REALTORS® with a general overview of contract issues relating to the negotiation and formation of purchase agreements. Knowledgeable REALTORS® can anticipate, address, and resolve potential problems with greater ease.

A. Contract Formation

A contract for the sale of land must be specific. Michigan law generally requires that the contract clearly identify the property, parties, price and terms of payment. The purpose of this requirement is to ensure that the contract clearly establishes the obligations of the parties. The written contract alone should be sufficient to determine the parties' intent. In addition to Michigan

law generally, the rules promulgated under the Occupational Code require REALTORS® to make certain that all terms and conditions of the real estate transaction are included in the offer to purchase. While standard form purchase agreements typically include the basic elements, deal-specific terms such as the personal property to be included in the sale or special contingency clauses need to be carefully drafted.

Once a purchase agreement becomes binding, it can be difficult to negotiate changes. Both parties are bound by the agreement, and neither is legally required to make concessions or modifications. Therefore, it is essential that REALTORS® determine their client's needs before an offer is presented or accepted. Taking the time to anticipate problems will significantly reduce the likelihood of costly litigation later.

1. Signatures

To be valid, a purchase agreement must be signed by all the parties. Generally, the signatures do not need to be witnessed or notarized. If multiple parties are purchasing property together, each buyer's signature is required. Where property is being sold by a married man, his wife's signature is required even if the property is held in his name alone, due to the wife's dower rights in the property.

A party cannot orally authorize someone else to sign a real estate contract on that person's behalf. Oral permission, even to a spouse, is insufficient. REALTORS® are sometimes asked to sign a purchase agreement on behalf of a client. REALTORS® who sign a purchase agreement on behalf of a client run the risk of the client later claiming that a particular provision -

- or the contract as a whole -- is unacceptable to that client. Since most clients are accessible via fax or overnight delivery, this is rarely necessary and should be discouraged. A party's faxed signature should be sufficient, particularly if the contract includes a clause permitting faxed signatures. If a REALTOR® feels it is necessary to sign a purchase agreement as an agent for a client, the REALTOR® must first obtain a power of attorney specifically authorizing that signature. The REALTOR® should also sign the purchase agreement so as to demonstrate the capacity in which they sign, e.g., "REALTOR® Smith acting as attorney-in-fact for Seller Smith."

As an aside, we would recommend against drafting a clause that provides for facsimile signatures "with originals to follow." This language could create an ambiguity as to when the contract is binding -- whether upon the transmission of the facsimile signature or the delivery of the original. Language such as the following is preferable:

> Execution of a facsimile counterpart of this Agreement shall be deemed execution of the original Agreement. Facsimile transmission of an executed copy of this Agreement shall constitute acceptance of this Agreement.

2. Presentation of Offers

Licensing rules require REALTORS® to promptly present an offer to a seller. In the case of multiple offers, REALTORS® must present all offers, but, contrary to popular belief, the law does not require REALTORS® to present multiple offers in the order in which they are received. Nor is a seller required to reject one offer before considering another offer. A listing agent has a fiduciary duty to advise his client about all offers prior to having that client make a decision on

any offer. The seller can then accept the most desirable offer and reject -- or simply ignore -- the other offers.

The Occupational Code provides that once an offer has been accepted, a REALTOR® is under no obligation to present additional offers received after the purchase agreement has been fully executed, unless required by the listing agreement. This provision of the Occupational Code would not protect a REALTOR® from a claim that he breached his fiduciary duty by failing to present such an offer. Accordingly, REALTORS® who do not want to present additional offers after a purchase agreement is signed should expressly so state in their listing contracts.

Example 1

REALTOR® receives an offer from Buyer A. REALTOR® is anticipating an offer from Buyer B later that day. REALTOR® waits until both offers are received and presents them to Seller the next morning. Buyer A is angry that his offer was held until another offer was received.

REALTOR® is required to present offers within a reasonable amount of time. Holding an offer a few hours in anticipation of another offer is not prohibited by the rules, and may be in the Seller=s best interest.

Example 2

REALTOR® receives offer A, followed by offers B and C. REALTOR® determines that offer A isn't as good as offers B and C. REALTOR® presents offer B first, followed by offer C. Seller decides to accept offer C, so REALTOR® does not present offer A.

REALTOR® has violated the rule requiring the presentation of all offers received before a binding purchase agreement is signed. Moreover, REALTOR® has breached his fiduciary duties owed to the Seller by failing to disclose the existence of offer A.

Example 3

REALTOR® presents offers A and B to Seller. Seller accepts offer B. The next day, REALTOR® receives offer C.

In order to protect himself, a REALTOR® should present offer C to the seller unless there is a provision in the listing agreement that indicates that subsequent offers will not be presented after the purchase agreement is signed. Seller, however, is bound by the acceptance of offer B, assuming delivery of acceptance has been made for offer B.

Sellers faced with multiple offers are often tempted to counter more than one of the offers. Obviously, a seller with two (or more) outstanding counteroffers runs the risk that both will be accepted and he will be contractually obligated to sell the property to two different buyers. A seller should never have two outstanding counteroffers at the same time -- at least without some carefully drafted language which protects the seller from having more than one accepted counteroffer.

3. Rejection/Acceptance/Counteroffer

An offer typically remains open until one of the following occurs: 1) the offer automatically expires at a specific date and time set forth in the offer; 2) the offer is revoked; 3) the offer is rejected or countered; or 4) the offer is accepted. If none of these events occur, courts have generally held that the offer expires after a "reasonable" time.

Frequently, offers contain express expiration dates. Such a clause usually provides that if the offer is not accepted by a specific date and time, it becomes null and void, and cannot thereafter be accepted. Occasionally, a party will want to revoke an offer prior to the 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).

If an offer has been presented to the seller, but the buyer changes her mind, the offer can be revoked before it is accepted by the seller. A revocation does not need to be in writing, and can be conveyed to either the seller or the seller's agent (this could be either the listing agent or a sub-agent). Once an offer is revoked, it cannot be accepted by the seller.

A counteroffer is deemed a rejection of the offer and itself becomes an offer. Sellers cannot simultaneously "accept" and modify an offer. Accepting an offer with any material change creates a counteroffer and is not binding unless accepted by the other party. Almost any modification, no matter how small, constitutes a material change.

Once an offer is rejected, it cannot be accepted. If a counteroffer is rejected, the seller cannot later change his mind and accept the original offer.

Example 1

Buyer presents an offer to Seller for $100,000. Seller accepts, but adds a provision requiring proof of financing approval within 30 days.

Seller has rejected Buyer's offer and presented a counteroffer with a new condition. There will not be a binding purchase agreement unless and until Buyer accepts the counteroffer.

Example 2

Buyer presents an offer to Seller for $100,000. Seller presents a counteroffer for $105,000. Buyer rejects the counteroffer. Seller signs and delivers the original offer. Buyer refuses to accept the executed purchase agreement.

The purchase agreement is not binding because the Seller's counteroffer constituted a rejection of the Buyer's original offer. Seller's attempt to accept the Buyer's original offer would operate as a new offer to the Buyer.

An offer is not accepted until it is signed and the fact that the offer has been signed is communicated to the offeror. Typically, unless the contract expressly provides otherwise, this communication must be in the form of delivery of the signed acceptance. Delivery can be to the offeror or his agent. Orally communicating the fact that the offer has been signed is not sufficient to bind a party to the purchase agreement, unless the contract expressly so provides.

As stated above, delivery can be made to either the party or their agent. Years ago, when nearly all REALTORS® involved in residential transactions represented the seller, the rules governing delivery were simple -- delivery to the REALTOR® constituted delivery to the seller. With the relatively recent surge of buyers' agents, this general rule no longer applies. It is now necessary to assess who a REALTOR® represents to determine at what point the parties have a valid purchase agreement and are bound by the transaction. Delivery to a buyer is effective when received by a REALTOR® acting as the buyer's agent. Similarly, delivery to the seller is effective

when presented to a REALTOR® acting as the seller's agent, whether as the listing agent or a sub-agent.

Example 1

Buyer makes an offer through Buyer=s REALTOR® who is acting as a buyer=s agent. Buyer's REALTOR® delivers the offer to the listing agent who presents it to Seller. Seller accepts the offer and delivers it to the listing agent. The listing agent delivers the signed purchase agreement to Buyer's REALTOR®.

The parties have a valid, enforceable contract for the sale of the property. Buyer could not then revoke or withdraw her offer, and Seller could not then revoke or withdraw his acceptance.

Example 2

Buyer makes an offer through Buyer's REALTOR® who is acting as a buyer's agent. Buyer's REALTOR® delivers the offer to the listing agent who presents it to Seller. Seller accepts the offer and delivers it to the listing agent. The listing agent calls Buyer=s REALTOR® and states that the offer has been accepted. Before the listing agent can deliver the signed purchase agreement to Buyer's REALTOR®, Seller calls the listing agent and informs the agent that Seller wishes to revoke his acceptance.

The listing agent should not deliver the document to Buyer's REALTOR®. The contract is not enforceable because it was not delivered to the buyer or the buyer's agent. Generally, unless the contract otherwise provides, oral notification of acceptance is not sufficient to bind a party to a purchase agreement.

Example 3

Buyer makes an offer through Buyer's REALTOR® who is acting as a buyer's agent. Seller accepts the offer and delivers it to the listing agent. The listing agent delivers the signed purchase agreement to Buyer's REALTOR®. The listing agent returns to the office and gets a call from Seller saying Seller wants to revoke the acceptance. Before Buyer's REALTOR® has a chance

to deliver the purchase agreement to Buyer, the listing agent calls and informs Buyer's REALTOR® that Seller wants to revoke the acceptance.

The contract is enforceable and cannot be revoked by Seller or the listing agent. Even though Buyer does not yet know the offer has been accepted, it was signed by Seller and delivered to Buyer's agent. If Seller refused to proceed with the sale, Seller would be in breach of contract. The Buyer could sue for specific performance of the contract.

Example 4

Buyer makes an offer through a REALTOR® who is acting as a sub-agent for Seller. Seller accepts the offer and delivers it to the listing agent. The listing agent delivers the signed purchase agreement back to the sub-agent who prepared the offer for Buyer. Seller calls the listing agent who notifies the sub-agent that Seller is rescinding the acceptance.

If the sub-agent has not delivered the purchase agreement to Buyer, the sub-agent should not deliver it. As a seller's agent, the sub-agent has a fiduciary duty to the seller which would be breached if the contract is delivered against the seller's wishes. If the purchase agreement has not been delivered to Buyer, the acceptance is revoked and the contract is not enforceable.

There is a misconception among some REALTORS® that a purchase agreement is not binding until "bottom lined." In actuality, there is a valid, binding purchase agreement once an offer is presented by the purchaser and accepted by the seller. The "bottom line" signature serves only as verification that the signed purchase agreement has in fact been provided to the buyer. (The Occupational Code requires licensees to deliver "true executed copies of the acceptance" to the buyer -- the bottom line signature merely serves as a confirmation that this was done.) Even if a buyer refuses to sign the "bottom line" of a purchase agreement, it is nonetheless binding and in full force and effect.

Example

> Buyer presents an offer to Seller. Seller accepts the offer by signing and delivering it to Buyer without making any changes. Buyer changes mind after delivery and refuses to "bottom line."
>
> *The purchase agreement is binding. Buyer's refusal to "bottom line" the agreement does not alter its status as a fully executed, legally binding contract.*

Finally, REALTORS® representing buyers who have put in an offer on a home are often frustrated when they receive no written response from the seller, particularly where the buyer's offer is close to the listing price. A buyer who receives no counteroffer or other indication in writing that the seller has considered and rejected his offer, may question whether his offer has in fact been presented to the seller. REALTORS® representing a buyer in this situation often call the MAR Hotline to inquire as to whether the seller is required to reject the offer in writing. The simple answer to this question is "no." A seller who receives an offer can accept, reject or counter that offer in writing. In addition, the seller can simply do nothing. A buyer can request that the seller respond in writing, however, the seller has no legal obligation to do so. If the seller neither accepts nor rejects the offer, the offer will expire after a reasonable time (or until it expires under its own terms or is otherwise revoked by the buyer).

4. Back-up Offers

If questions raised on the MAR Legal Hotline and requests for assistance to the MAR Legal Action Committee have any value as an indicator of current trends, then it would appear that REALTORS® in Michigan are now, more than ever before, using back-up offers in

marketing real estate. While there is nothing legally wrong with using back-up offers, great care must be used in drafting back-up offers. Hastily drafted back-up offers can result in litigation which effectively ties up a piece of property until the seller, the REALTOR®, a prospective buyer, or some combination of those persons, writes a check to another prospective buyer to get him to go away.

Problems with back-up offers appear to arise under essentially the same set of facts. REALTOR® Jones has a listing for the Smith property for $100,000. The Browns become interested in the Smith property and offer $99,000 for the property, subject to contingencies which include an inspection. The Smiths accept the Browns' offer. Within 24 hours, the Greens (who previously looked at the Smith property) submit an offer for $98,500. The Smiths express concerns about the contingencies in the Browns' offer, and request that REALTOR® Jones take whatever steps she needs to take in order to keep the Greens interested in the property.

REALTOR® Jones prepares a counteroffer to the Greens' offer in which it is indicated that the Smiths are accepting the Greens' offer as a back-up to the Browns' "purchase agreement dated March 16, 1999." This counteroffer is accepted by the Greens.

In the meantime, the Browns undertake their inspection of the Smith property. The Browns discover problems with the septic system and the well on the Smith property, and initiate a negotiation to amend the purchase agreement dated March 16, 1999 to obtain a credit for $2,200, which is equal to the estimate that the Browns have obtained to fix the problem with the septic system and the well. The Smiths discuss this proposed amendment with REALTOR® Jones,

and ultimately conclude that it is acceptable. On March 28, 1999, the Smiths and the Browns enter into an amendment of the purchase agreement dated March 16, 1999. A closing is scheduled for April 20, 1999.

Unfortunately, on April 20, 1999, REALTOR® Jones cannot conduct a closing of the sale from the Smiths to the Browns. The closing cannot occur because the Greens have filed a lawsuit and filed a lis pendens against the Smith property, claiming that they have a binding purchase agreement with the Smiths to purchase the property. The Greens' position in court is that their offer was a back-up to the Browns' purchase agreement of March 16, 1999. When the Smiths and the Browns amended the March 16, 1999 purchase agreement, they entered into a new deal dated March 28, 1999. Thus, it is the Greens' position that their back-up offer became effective on the date that the Smiths and Browns attempted to modify the March 16, 1999 purchase agreement.

REALTORS® should be aware that there are cases pending in court at this time based on this pattern of facts. There are no known judicial decisions of record based on this set of facts for a very simple reason. The Smiths want to sell their home and both the Browns and the Greens claim they have binding contracts to purchase the Smiths' home. Typically, the Smiths and the Browns, or the Smiths and the Greens, along with REALTOR® Jones, end up paying the other potential buyers to go away so that the transaction can be completed.

There is absolutely no reason for REALTORS® to find themselves, and the sellers and buyers whom they represent, in this situation. REALTORS® should develop consistently-used

uniform language which has been approved by their counsel when they prepare back-up offers. In the past, we have prepared a provision which REALTORS® could use with back-up offers in order to avoid this situation. This clause provides as follows:

> "Buyer acknowledges that this Agreement is a back-up offer which shall be effective only in the event that the closing on the prior purchase agreement on the property does not take place for any reason. Buyer acknowledges that nothing in this Agreement shall in any way restrict the right of the Seller to modify the terms of the prior purchase agreement as Seller shall, in his sole discretion, deem advisable."

Obviously, REALTORS® can opt to use whatever clause they wish to use in handling back-up offers. They simply need to make sure that they include language such as the above-quoted language in the backup offer to make certain that they do not end up with competing claims by buyers which tie up the property in court.

There is another potential issue with backup offers from the second buyer's perspective. In the above scenario, to what extent are the Greens bound to wait for the Smiths' home? Suppose four (4) weeks go by and the closing with the Browns is still up in the air. Can the Greens resume their search for a home to purchase or are they bound to wait longer to see if the Smiths sell their home to the Browns? Again, this can be clarified by a provision in a backup offer which provides:

> In the event that the Sellers do not notify the Buyers that this backup offer is in first position within two (2) weeks of the date hereof, the Buyers may at any time thereafter declare this agreement null and void by providing written notice of same to the Sellers.

B. Contract Performance

1. Amendments to Contracts

Performance under a purchase agreement is governed by the terms of the contract. The terms of a purchase agreement are binding upon all parties to the contract and cannot be modified without their consent. Any amendments to the terms of the contract should be in writing and must be signed by all parties. The need for amendments frequently arises when one party is unable to or will find it difficult to perform under the terms of the contract. For example, a buyer may not be able to obtain financing within the time allowed in the contract, and may request an amendment for additional time to obtain financing.

A party who wants to modify a purchase agreement frequently submits a proposed addendum. The addendum is handled in much the same way as the original purchase agreement. It is an offer to amend the contract which can be accepted, rejected, revoked, or countered. A party is under no obligation to accept a proposed addendum; however, once accepted, it becomes a binding portion of the original agreement.

Attorneys whose clients orally modify a term near or at the closing do not typically prepare an addendum to the purchase agreement. Accordingly, attorneys are often surprised when a REALTOR® presents a proposed addendum to the purchase agreement at closing. The reason that attorneys handle changes to the purchase agreement differently than REALTORS 7 is because of a requirement contained in the Occupational Code. While attorneys are not

obligated to do so, the Occupational Code requires REALTORS® to prepare closing documents consistent with the purchase agreement. In order to comply with the Code, REALTORS® should prepare addenda to purchase agreements making them consistent with the closing documents.

Some REALTORS® have the misconception that if an addendum is proposed and rejected, the purchase agreement is terminated. This is not the case. If an addendum is rejected, the purchase agreement remains in full force and effect. A party can neither change the terms of a purchase agreement nor terminate the purchase agreement without the consent of all parties to the transaction. If a party fails to perform under the purchase agreement, that party is in breach of that purchase agreement.

2. Time for Performance

Consider the following scenario. Seller Jones and Buyer Smith have entered into a buy/sell agreement which is contingent upon Smith obtaining financing within fourteen (14) days and requires a closing within twenty one (21) days. Smith's loan application is delayed several times. In the meantime, Seller Jones receives a second offer on his home which is better than Smith's offer. At what point is Seller Jones free to sell his home to the second buyer? Unfortunately, the law is such in Michigan that there is no date at which Seller Jones can proceed "risk free" with the second buyer. As will be discussed below, Michigan courts do not strictly enforce time deadlines in purchase agreements.

As REALTORS® are well aware, real estate closings often do not occur as planned, with sellers and buyers frequently seeking oral or written agreements to extend closing dates,

based on financing delays, delays in the sale of the buyer's previous residence, or for numerous other reasons. While these delays might be irritating or frustrating to the seller, in general Michigan law does not permit the seller to terminate the purchase agreement and accept a more favorable offer, merely because the closing date specified in the purchase agreement has been delayed or postponed.

Michigan courts have held to these general rules for more than seventy-five years. Time of performance rules were first set forth in the leading case of Waller v Lieberman, 214 Mich 428; 183 NW 235 (1921). In that case, Waller signed a purchase agreement to buy property from Lieberman, and the deal was to have closed on September 8, 1916. Waller was hospitalized on September 7, and did not provide the money and documents needed by the escrow agent for closing before being hospitalized. Lieberman subsequently learned of Waller's illness and consented to postponing the transaction. However, Lieberman later attempted to cancel the transaction on December 12, claiming that Waller had defaulted, and Waller sued for specific performance.

In defense, Lieberman argued that "time was of the essence." In the real estate context, this basic principle of contract law means that where the parties agree that the time for performance is an essential element of the contract, the closing must occur on or before the date and time specified in the purchase agreement, or the agreement will be void. The court rejected this argument, observing that:

> [t]here is nothing in the written contract, or in the conduct of the parties, tending to establish the fact that time was of the essence of the contract, other than the naming of the due date; and it has been frequently held that the naming of the date on which the payment shall become due does not in itself make time of the essence of the contract. (Emphasis added.)

In addition, even though the parties to a purchase agreement intend that the contract be performed within the time specified, they may waive the time condition by oral or written agreement to extend the time for performance. The waiver then operates "as a waiver of the vendor of the right to rescind, or forfeit the contract for the failure of the purchaser to comply strictly with the term [thereof] relating to payment."

Courts have continued to follow the Waller decision, making additional refinements to the basic rules set forth above. For example, in Al-Oil, Inc v Pranger, 365 Mich 46; 112 NW2d 99 (1961), the parties signed a purchase agreement for the sale of property on which the buyer wished to construct a gas station. The purchase agreement obligated the buyer to obtain the necessary governmental permits and zoning within sixty days. While the buyer diligently worked on the approval process, keeping the sellers advised of his progress, the final approval was not obtained for more than four months. The sellers then refused to perform the contract, as they apparently believed that "they could sell the land for more money than [buyer] had offered if they could avoid carrying out their agreement."

The court rejected the sellers' argument that the sixty-day approval period made "time of the essence" for the performance of the contract, preventing the sellers from rescinding

the agreement based on the delay in closing. Not only did the mere naming of the time for performance in the purchase agreement not make "time of the essence," but the sellers also knowingly waived any time for performance requirement by their awareness of the buyer's ongoing efforts to obtain governmental approval. The Al-Oil court did note that rescission by a seller might be possible under very limited circumstances:

> Where a stipulation for performance at a particular time has been waived, the party in whose favor the waiver operates is thereafter bound only to perform within a reasonable time, except in a case where there has been a specific extension of time, in which case it is held that the new time fixed becomes of the essence, as was the case in the original contract. So, where the time fixed by the contract for performance is permitted to pass, both parties concurring, the time of performance thereafter becomes indefinite, and one party cannot rescind until full notice and a reasonable time for performance is given. 365 Mich, at 53 (emphasis added).

Michigan courts have repeatedly emphasized that due to the drastic effect of a "time is of the essence" provision in a real estate purchase agreement, i.e., the complete termination of the agreement if the specified closing date is not met, the buyer and seller must clearly intend time to be an "essential element" of their agreement. While the intent to include time as an essential element can be implied from the nature of the contract and the surrounding circumstances, such an intent must "necessarily" be implied. Nedelman v Meininger, 24 Mich App 64, 74; 180 NW2d 37 (1970).

Courts have also held that the use of form purchase agreements prepared by state or local boards of REALTORS®, and the inclusion of a specific closing date or time limit in the space provided on the form, does not independently make "time of the essence" to the parties' agreement. Kennedy v Brady, 43 Mich App 760, 763-764; 204 NW2d 779 (1973). As courts recognize, these types of forms are used for convenience, and do not constitute a true negotiated expression of the parties' intent to stress the importance of a specific time for performance. For example, in In re Day Estate v Plumb, 70 Mich App 242, 246; 245 NW2d 582 (1976), the court rejected a buyer's attempt to rescind a purchase agreement based on delay by the sellers, where the testimony of the real estate broker indicated that he inserted the thirty-day closing requirement in the purchase agreement as a "matter of course," not because of any concern by his clients that the contract be executed immediately.

The clear message from the above cases is that there is no foolproof manner for imposing time deadlines in purchase contracts which will be strictly enforced by Michigan courts. When faced with this issue, courts will look at the specific facts of the case to determine first whether the parties to the purchase agreement negotiated or otherwise stressed the importance of time deadlines in the purchase agreement and if so, whether the seller later waived or extended those time deadlines. Reliance on the time deadlines to rescind a purchase agreement based on the alleged failure to meet the time for performance established in the purchase agreement is a risky proposition. This is particularly true where the seller seeks to rescind in order to accept a better offer. REALTORS® who have clients who seek to terminate a purchase agreement as a

result of the seller's or purchaser's failure to meet certain time deadlines should advise those clients to seek the advice of an attorney.

3. Inspection Contingency Clauses

REALTORS® continue to try to cope with questions regarding inspection contingency clauses. Consider the following clause:

> "Buyer's offer is subject to a satisfactory inspection within ten (10) days.@

The problem with interpreting and applying this inspection clause arises under essentially the same set of facts. REALTOR® Jones has listed the Smith property for $100,000. The Browns submit an offer on the property for $95,000, which is accepted by the Smiths. The offer is subject to this inspection contingency. Upon obtaining an inspection, the Browns learn that the roof needs repair at an estimated cost of $1,900. They indicate to the Smiths that they will proceed forward with the transaction if they receive a credit against the purchase price for $1,900. Alternatively, in some situations, the Browns indicate that they will proceed forward with the purchase for $95,000 if the Smiths have the roof repaired to the Browns' satisfaction prior to closing. In either case, the Browns are requesting a modification of the existing purchase agreement.

The question most commonly asked in this situation is what is the status of the purchase agreement between the Smiths and the Browns. Have the Browns essentially advised the Smiths that the inspection was unsatisfactory and that they are terminating the transaction unless the Smiths agree to modify the transaction to account for the problems with the roof? Or,

alternatively, are the Browns simply requesting that the original agreement be modified but, in case the Smiths don't agree, the Browns have the option of proceeding forward with the sale for $95,000?

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 the inspection clause is silent and the Browns are well within the ten (10) day inspection period, the Browns may be able to carefully word their request so that it is clear that it is a proposed addendum, rather than a rejection of the original buy/sell agreement. The practical problem with this scenario 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.

Alternatively, the parties may wish to consider at the outset drafting the inspection contingency clause to anticipate 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:

> "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. Any request by the Buyers to modify this Agreement based upon the results of

> the inspection shall be deemed a termination of this Agreement by the Buyers."

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:

> 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. If the Sellers do not agree in writing to make such repairs, the Buyers may terminate the contract by providing written notice within the inspection period. Failure of the Buyers to respond in writing within the time periods set forth above shall constitute a waiver of this contingency.

Under this inspection contingency clause, 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. Keep in mind that under the language of this inspection clause, the Browns will have to inspect the property, make any repair request of the seller and decide whether or not to proceed forward, all within the ten (10) day inspection period.

Note that both sample inspection contingency clauses specifically state that a failure to act within the time frame allowed shall be deemed a waiver of the contingency. Too

often, an inspection contingency clause does not indicate anything other than the time period provided for the inspection. In other words, a buy/sell agreement often provides simply that it is contingent upon a satisfactory inspection within ten (10) days. Twenty (20) days later, the Smiths ask REALTOR® Jones what the status of the agreement is with the Browns, inasmuch as nobody knows whether they have conducted an inspection and/or whether they have any problems with the results of the inspection. The legal question is whether the Browns, by their silence, have waived their right to terminate the transaction based on the results of an inspection. Again, there is no Michigan case directly on point on this issue. However, this situation should never become an issue, as the inspection contingency clause should clearly indicate the result if a buyer does not provide any notice regarding an inspection of the property. The inspection clause should indicate that if the buyer fails to provide notice regarding the inspection, that 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.

C. Contract Termination

A purchase agreement can be terminated in many ways. A party may terminate it as permitted under one of the contingencies, the buyer may elect to terminate under a statutory provision (such as the Seller's Disclosure Act), the parties may agree by mutual consent, or a party may breach the contract.

Contrary to popular belief, there is no three-day right of rescission for contracts for the sale of real estate. There are consumer protection statutes which provide a rescission period

in certain circumstances (such as telephone or door-to-door sales), however those statutes do not apply to contracts for the sale of real estate.

REALTORS® are sometimes approached by buyers or sellers who have changed their minds and want to be released from the contract. The REALTOR® may be inclined to convince their clients that they must go forward with the sale so that the REALTOR®'s commission is not jeopardized. However, REALTORS® should be wary of doing so in light of their fiduciary duties. It may be in the client's best interest to obtain a release. If a REALTOR® is approached by a client who now wants out of the contract, the REALTOR® should advise the client to seek the advice of an attorney. It is in a REALTOR'S7 best interest to have his client rely on the advice of an attorney as to the enforceability of the contract.

It is not uncommon for both parties to agree to terminate the contract. For example, the buyer may be having difficulty obtaining financing at the desired interest rate, and the seller may have other interested buyers in a position to close. The parties may agree to terminate the purchase agreement by signing mutual releases. Such releases should always provide for the disbursement of the earnest money deposit.

If the parties do not mutually agree to a release, but one party refuses to go forward with closing, the contract is terminated by the party's breach of contract. The non-breaching party may have legal remedies including specific performance or damages incurred as a result of the breach. REALTORS® should never make determinations as to whether a party has in fact breached the contract, but again should refer the client to an attorney. While a breach of

contract by the buyer likely means the seller is free to sell the home to someone else, in the absence of a release, this determination should be made by an attorney. A REALTOR® does not want to be responsible for putting a client in a position where two buyers are claiming they have a valid purchase contract.

Based upon calls received on the Legal Hotline, there appears to be a common misconception that if the contract is terminated, a house cannot be sold to someone else while the earnest money is in dispute. This is incorrect. The status of the earnest money has no bearing on the seller's ability to sell the home. The primary concern is that the seller might still be bound by the first purchase agreement in the absence of a written release. A release can be executed leaving the earnest money in dispute. If a release cannot be obtained, the REALTOR® should advise the sellers to contact an attorney to determine whether they are in fact free to sell the home to another buyer.

When a sale does not close, the earnest money is frequently in dispute. REALTORS® should not disburse the earnest money to either party in the absence of signed releases or a court order. A REALTOR® who releases money to one party may find himself obligated to pay the other party if a court should later disagree with his assessment of the rights of the parties. A REALTOR® faced with a buyer and seller who both claim the earnest money deposit can bring an interpleader action, in which a court will make the determination as to the proper disbursement of the funds. REALTORS® are not required to bring such an action. Rather, they can retain the money until such time as the parties agree -- or a court issues an order -- as to the disbursement of the funds.

III. CONCLUSION

REALTORS® should utilize their knowledge of contract concepts to help make the process go smoothly. A solid understanding of the concepts addressed in this article will enable

REALTORS® to better serve their clients and reduce their own potential liability. When problems arise, however, REALTORS® should advise their clients to contact an attorney rather than offer legal advise as to the interpretation and/or enforcement of the contract terms.