Real Estate Litigation: Avoid It or Win It

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SMITH ANDERSON

Real Estate Litigation: Avoid It or Win It

Presented by
Scott A. Miskimon

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Litigation and Real Estate Transactions

- Avoid litigation if you can through proper contract drafting, execution and performance
- If you can't avoid litigation . . . then win it!

Reasons to Avoid Litigation

- Expense
- Distraction
- Depositions of executives, brokers and closing attorneys
- Documents are subpoenaed
  - All of your emails will be read!
- Unhappy buyers and sellers
- Ancillary disputes

Broker Lien Rights

N.G.G.S. § 44A-24.1 *et seq.*

Broker Lien Rights

- Licensed NC brokers
- Applies to commercial real estate
  - Used for sales, office, institutional, industrial, warehouse, manufacturing or multi-family residential with 5 or more units
- Requires broker to have performed
- Brokerage agreement clearly sets forth broker's duties, conditions for compensation and amount

Broker Lien Rights

- Lien on property that is subject of the brokerage agreement
- Enforced by broker filing suit
- Property can be foreclosed upon
- Attorneys' fees recoverable
- Leverage against land owner

Avoiding Litigation and Managing Risk on the "Front End"

- Proper contract drafting
- Proper performance by the client, its employees and agents

Proper Contract Drafting And Execution

- Signatures
  - All owners (and their spouses)
  - Spouses – usually not agents for each other
  - Attorneys – power to bind clients
  - Brokers – has client conferred upon the broker the power to bind the client?
- Emails can form binding agreements
- Pre-Audit Certificate required for contracts with counties and cities
- Time is of the essence clause
  - If not stated in the contract, then a “reasonable time” to close – which is a jury question
- Attorneys’ fees clause

Reciprocal Attorneys' Fees Clauses In "Business Contracts"

N.C.G.S. § 6-21.6

- Transfer expense and risk to your opponent
- Possible deterrent for litigation
- Possible pressure point for settlement

Attorneys' Fees Provisions

- General Rule: Attorneys' fees can only be recovered if authorized by a North Carolina statute

- Original Law: N.C.G.S § 6-21.2
  - Applies to "evidences of indebtedness" (such as promissory notes and leases)
  - Not reciprocal:
    - recovery of fees by only one party = the "creditor"
  - Magic words:
    - "reasonable attorneys' fees" = 15% of outstanding principal and interest
  - Requires written notice to debtor of intent to recover attorneys' fees

North Carolina's New Attorneys' Fees Statute

- New Law: N.C.G.S § 6-21.6 (Effective October 1, 2011)
- Reason for the new law:
  - Enforces obligations to pay attorneys' fees for breaches of business contracts
  - Expansive scope as to types of contracts and who may recover attorneys' fees
  - Not limited to "evidences of indebtedness"
  - Gives effect to freedom of contract
  - Intended to make North Carolina a more business-friendly state

North Carolina's New Attorneys' Fees Statute

- What is covered:
  - Applies to a "business contract"
    - entered into on or after October 1, 2011
    - if it contains a reciprocal attorneys' fees provision
      - each party agrees to pay the other party's attorneys' fees and expenses that were incurred by reason of any suit, action, proceeding or arbitration involving the business contract
  - A business contract is "a contract entered into primarily for business or commercial purposes"

North Carolina's New Attorneys' Fees Statute

- What is not covered:
  - Consumer contracts
  - Employment agreements
    - Personal services agreements made with an individual
    - Either as an employee or independent contractor
  - Contracts made with the State of North Carolina or with any State agency

North Carolina's New Attorneys' Fees Statute

- What is not covered:
  - Electronically-formed contracts
    - Statute expressly states the contract must be "signed by hand"
    - Not for web-based "click accept" agreements

North Carolina's New Attorneys' Fees Statute

- Recovering attorneys' fees
  - In the discretion of the judge or arbitrator as to
    - Whether to award fees
    - How much to award

North Carolina's New Attorneys' Fees Statute

- Based on all the circumstances including 13 non-exclusive factors
  - the extent to which the party asking for attorneys' fees prevailed in the action
    - Being a prevailing party is not an absolute requirement to recover fees
  - the terms of the contract
    - Query: Do the parties have the freedom of contract to insist that only a prevailing party may recover attorneys' fees?
  - the amount in controversy
  - the amount of damages awarded
  - the reasonableness of the amount of fees requested
  - the relative economic circumstances of the parties
  - the timing and amount of settlement offers

North Carolina's New Attorneys' Fees Statute

- Prohibitions
  - Recovery of fees based on any stated percentage of the obligation or damages
  - In a claim for money damages, the amount awarded cannot exceed the amount of monetary damages that are awarded

North Carolina's New Attorneys' Fees Statute

- Advantages and Disadvantages
  - Optional
  - Flexible (assuming parties have freedom to impose additional requirements)
  - Reciprocal
  - Broad in scope and not limited to "evidences of indebtedness"
    - Permits election between earlier and new attorneys' fees statute if the contract qualifies under both statutes
  - Prohibition against fixed percentage recovery will create uncertainty and expense

North Carolina's New Attorneys' Fees Statute

- Include a Reciprocal Attorneys' Fees Provision?
  - How expensive do you think litigation will be?
  - How will the cost of litigation compare to the amount of damages likely at issue?
  - What's the company's risk tolerance for paying damages, its own attorneys' fees and the attorneys' fees of its opponent?
  - Is reciprocity desirable?

North Carolina's New Attorneys' Fees Statute

- Suggestions
  - Examine your existing form agreements
  - Carefully consider new contracts

More on the New Attorneys' Fees Statute . . . Article "A New Day Dawns in North Carolina"

- On the Smith Anderson webinar page

Avoiding Litigation Through Arbitration?

Purpose of Arbitration: Private dispute resolution through binding arbitration

- No jury trial
- Less formal procedures
- Potential for limited discovery
- Potentially quicker
- Potentially cheaper
- No lengthy or complicated appeals process
- Private

Arbitration?

Drafting Sample (for illustrative purposes only):

Arbitration: Any controversy or claim (including, without limitation, any claim based on negligence, misrepresentation, strict liability or other basis) arising out of or relating to this Agreement or its performance or breach, shall be settled by arbitration in accordance with the rules of the American Arbitration Association, if arbitration is demanded by either party. The decision in such arbitration shall be final and binding and any award rendered thereon may be entered in any court having jurisdiction.

Arbitration?

Warning: Select arbitration if

- You don't want a jury
  - You're comfortable with 3 decision makers and perhaps only 1 decision maker
- You want only 1 bite at the apple
  - If you lose, you're comfortable with no right of appeal
- You're comfortable with trial by ambush
- You're comfortable with the idea that the arbitrator may *not* apply the law
  - You're comfortable with arbitration's perceived inclination to award at least *some* relief even in cases where a court might deny *any* relief

Arbitration?

Warning:

- The cost of arbitration could be as much as the cost of litigation
- Select arbitration if you want to pay for
  - Large filing fees
  - Your own decisionmaker(s)
  - Your own case administrator
  - Your own courtroom
  - Your own court reporter

Pre-Audit Certificates

- A statutory formality required for contracts with a county or city
- Certificate signed by the municipality's finance officer
- Confirming funds in budget for performance in the fiscal year
- Without it, no recovery against municipality under <u>any</u> theory

More Regarding Pre-Audit Certificates . . . Smith Anderson Client Alert “Risky Business”

- On the Smith Anderson webinar page

Avoid Litigation by Proper Performance

- Follow the contract's terms
- Avoid waiver of terms
- Meet deadlines
- Give proper notices and confirm receipt
- Changes are clearly documented in writing

Client and Broker Conduct and Statements Can Affect Rights and Obligations

- The contract terms matter
- What the parties and agents say and do after the contract is signed may be more important
- Contract terms can be *waived* by conduct, verbal statements and by emails
- Rights and obligations can change in unexpected ways

Waiver of Contract Terms

Case Study: *Phoenix Limited Partnership of Raleigh v. Simpson*, 201 N.C. App. 493, 688 S.E.2d 717 (2009).

- Land in downtown Raleigh
- Closing date in contract = “time is of the essence”
- No closing occurred because of contamination
- Buyer did not tender the purchase price
- Seller did not tender a deed
- Seller promised to cleanup the land
- Parties did not communicate for 2+ years
- Buyer sued 4 years after the closing date seeking specific performance

Waiver of Contract Terms

Seller's arguments and defenses:

- Time was of the essence for closing
- Contract contained a "no oral modification" clause and the parties didn't agree in writing to a new closing date
- Seller had no duty to clean up the land
- Buyer failed to timely close
- Buyer abandoned the contract

Waiver of Contract Terms

Buyer's case:

- Seller could not close on time because of environmental contamination discovered during due diligence
- Seller indicated it would clean-up the property and then close
- Buyer waited for Seller to complete clean-up

Waiver of Contract Terms

Buyer's case:

- Time is of the essence clause was waived
- Parties had instead a reasonable time to close
  - Time for closing would begin when Seller gave notice it was ready to close
  - Seller never completed the clean-up
  - Contract #2 was a breach
    - Seller anticipatorily repudiated by contracting to sell the land to a third party for more money

Waiver of Contract Terms

Result:

- Time is of the essence clause was waived as a matter of law
- Because Seller was never ready to close, the clock never started running for the “reasonable time to close”
- Seller breached as a matter of law
- Seller was ordered to deliver a deed
- Closing finally took place . . . .
- Ancillary disputes also took place . . . .

Waiver of Contract Terms

Statements of Seller's Broker after the closing date were key to finding waiver of the time-is-of-the essence clause

- Repeated references to the "sale and purchase of the property"
- Discussion of efforts by Seller's environmental consultant
- Promise to deliver a copy of the environmental consultant's report
- Seller intended to put the property into a State environmental clean up program
- "We will communicate with you as time goes by."

Waiver of Contract Terms

Takeaways:

- In litigation, the written contract is only the first step in the analysis
- How the contract was/was not performed may be more important
- Written contract terms can be waived by statements or conduct
  - By clients, agents and attorneys

Waiver of Contract Terms

Takeaways:

- Even “Time is of the essence” clauses can be waived by conduct
  - If the parties didn’t care about their deadline, don’t expect a judge will care
- Key contract terms can be nullified because of conduct
  - Actions speak louder than words
- Follow the contract and keep promises

More about the *Phoenix* case . . . Article “The Nine-Year Closing”

On the Smith Anderson Webinar Page

When the Deal Goes Sideways . . . . Managing Risk on the "Back End"

- Develop a strategy to prevent litigation
- Shape the narrative of the facts
- Develop a strategy to win the litigation
- Execute the strategy

Developing a Strategy

- What does this mean?
  - Strategies depend on client's goals
  - Strategies depend on the law
  - Strategies are fact-specific
  - Chronology is key
- Who will do it?
  - Client?
  - Broker?
  - Closing attorney?
  - Litigator?
- When?

TIP:
When the Deal Goes Sideways, Act in Accordance with the Law

- What to do when a party clearly repudiates the contract?
- What's the right response?
  - Immediately file a lawsuit
  - Do nothing
  - Send a letter demanding a closing

The Law of Anticipatory Repudiation

- Repudiation comes before performance is due
- Repudiation is a "positive, distinct, unequivocal and absolute refusal to perform the contract"
  - Has to be crystal clear
  - Practically, it needs to be in writing
  - Non-repudiating party has to treat the repudiation as a breach of contract

The Law of Anticipatory Repudiation

- The non-repudiating party has to choose between 2 paths:
  - Treat the repudiation as a breach and sue immediately -- or provide written notice that he is now discharged
    - Risk that non-repudiating party is wrong and puts himself in breach
  - Ignore the repudiation and proceed to perform the contract
    - Waive the repudiation
    - Requires waiving party to perform or at least tender his performance

The Law of Anticipatory Repudiation

- How to waive a repudiation
  - Claim that you're ready, willing and able to close
  - Demand that the repudiating party close
- Risks
  - Waiving party is still obligated to timely and fully perform
- Lessons:
  - Know the law
  - Develop the right strategy

More about Anticipatory Repudiation . . . See Article "Buyer Beware"

- On the Smith Anderson webinar page

TIP: Avoid Litigation By Not Having Two Buyers

A Seller of Land Should Never Have Two Buyers, Unless Either . . . .

- Contract #2 is a back-up contract as permitted by Contract #1
  - Avoid tortious interference claim by Buyer #1 vs. Buyer #2
- Contract #1 is rescinded/terminated in a written contract signed by Seller and Buyer #1
- See Articles “The Nine-Year Closing” and “Buyer Beware”

The "Standard Approach" in Litigation

The Usual Sequence in Litigation:

- Complaint
- Answer
- Interrogatories
- Document discovery
- Depositions
  - Secondary witnesses first
  - Key witnesses later
- Motion for Summary Judgment

Something Other than the "Standard Approach" May be Better

- Is the "Standard Approach" the right approach for your case?
- Filing a Complaint or Answer and hoping for a settlement is not a strategy
- Develop a strategy that is proactive and not reactive
- Push hard = spend $
- Discovery very early
  - Depositions of key players
  - Lock in testimony early
- Discovery sets the table for dispositive motions and settlement

Something Other than the "Standard Approach" May Be Better

- Pushing hard has its advantages
  - Reacting to your tactics is not a winning strategy for your opponent
  - The more your opponent is merely reacting, the greater the likelihood he will make mistakes
  - Locking in testimony early limits your opponent's ability to maneuver
  - Don't educate your opponent about weaknesses in his case until it's too late for him to correct his problems

Something Other than the "Standard Approach" May be Better

- Be aggressive with motions
- Motion to dismiss the Complaint
- Motion to strike affirmative defenses in the Answer
- Motions for Summary Judgment
- Narrow the issues
- Goals:
  - Either win the case outright
  - Set the table for a favorable settlement

Thank you for attending today's Real Estate Development Law webinar.

Don't forget…

- Today's Power Point presentation, audio recording and related articles are available on Smith Anderson's website at www.SmithLaw.com/Webinar, and all past recorded webinars are available to view and download too.

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The Nine-Year Closing

How Your Client's Conduct Can Change Its Contractual Rights and Obligations

by Scott Miskimon

Buyer and seller agree to a sale of land. The land is contaminated. The buyer is unhappy. The closing is delayed. For nine years. What's a seller to do? The case of **Phoenix Limited Partnership of Raleigh v. Simpson**, 2009 N.C. App. LEXIS 2324, 688 S.E.2d 717 (2009) offers a number of reasons why parties to a real estate contract have to carefully proceed when problems of performance arise. Counsel involved have to pay particular attention to issues of whether their client's conduct has profoundly changed what would otherwise be clear contractual language subject to well-settled rules. When the client's course of performance negates contract terms or expands an obligation, the rules are suddenly different. Assuming that the original contract terms remain unchanged is a dangerous assumption that can lead to lengthy and expensive litigation and increase the client's exposure to damages.

Exercising A Put Option – A Cautionary Tale

In **Phoenix**, the parties' relationship evolved over the course of 15 years from landlord and tenant, to buyer and seller, to plaintiff and defendant and, finally, to grantor and grantee. In 1995, the plaintiff tenant/buyer entered into a five-year lease for a surface parking lot located in downtown Raleigh near the corner of McDowell and Davie streets. The lessors were individuals who had owned the land for many years and whose family members were their predecessors in title. The land was three-quarters of an acre and had once been the site on which a dry cleaner and an auto repair shop operated. The lease contained provisions that would ultimately determine how the parties' relationship would conclude: a put and call provision allowing each party to the lease to exercise an option requiring the other party to either buy or sell the land, as the case may be; a clause providing for environmental warranties and representations; and an indemnity clause.

In September 2000, just two weeks before the end of the lease term, the landlord exercised the put option requiring the tenant to purchase the property. Consequently, a bilateral contract of purchase and sale was then formed. The terms for the sale were set forth in the lease. The purchase price was to be based on the land's fair market value as of the date the put option was exercised and was to be determined by an appraisal process. Following the exercise of the put option, the tenant/buyer commissioned a Phase I environmental assessment. This report prompted the buyer to commission a Limited Phase II environmental site assessment. The appraisers were aware of this situation and stated in their report that their estimated value of $947,500 was subject to downward adjustment depending on the land's environmental condition.

Closing was supposed to take place within 180 days from the date when the put option was exercised. As to this closing date, the contract stated that "time is of the essence." Because of the environmental issues and the specter of a downward price adjustment, the sellers did not deliver a deed by the closing date. Instead, a few weeks after the time-critical deadline for closing, the sellers dropped off a photocopy of an executed deed, but the deed was not notarized. No other seller documents as required under the contract were delivered to the buyer.

A month after the deadline for closing, a Phase II environmental site assessment was completed that showed the property was contaminated. The groundwater contained traces of "VOCs exceeding the laboratory quantitation limits" and soil testing indicated "the presence of chlorinated VOCs and BTEX compounds." The degree and extent of the contamination and remedial measures necessary to correct the problem could not be determined without further assessment.

In the contract, the sellers made express environmental warranties and representations, including that no commercial operation involving hazardous materials (including petroleum products) ever operated on the property. Although there was no express obligation to clean up the property if it was found to be contaminated, the sellers backed their environmental warranties with an indemnity in which they promised to hold the buyer harmless if the sellers breached their warranties. The sellers also promised to indemnify for pre-existing hazardous conditions, as well as for related fines, penalties, and costs.

In light of the Phase II, the contract's environmental provisions, and the purchase price being reduced because of the property's value being negatively affected by the contamination, the sellers were in a position where they had to choose between cleaning up the property or reducing the purchase price. The sellers opted for the first choice, which they pursued for more than one year. The sellers hired their own environmental consultant who examined the land, prepared a report that confirmed the contamination, and recommended that the property be put into the North Carolina Dry-Cleaning Solvent Cleanup Act program (the "DSCA program"). The sellers' real estate agent sent the buyer this report and notified the buyer that the sellers intended to put the property into the DSCA program. Eight months later, the sellers submitted a petition to the State for that purpose.

The buyer was aware of the lengthy timeframe for environmental remediation and was awaiting the results of the sellers' clean up efforts. During this time the buyer was also reserving funds needed to pay the full purchase price. The parties did not communicate with each other from December 2001 until August 2004. During this time, the sellers were represented by an experienced attorney and an experienced real estate broker. Nevertheless, the sellers did not complete the process for putting the property into the DSCA program, and no environmental remediation was conducted. In 2003, the City of Raleigh decided to build its new Convention Center half a block away from the subject property. Soon thereafter, the sellers concluded that the buyer had abandoned the contract and that they were free to sell the property to someone else. In 2004, the buyer's counsel contacted the sellers about the property's environmental status. In response, he was informed that the property was back on the market. After the buyer's counsel warned the sellers that the buyer intended to enforce its rights under the contract, the sellers put the property under contract with a third party at a price $400,000 higher than the contract price with the buyer.

In January 2005, the buyer sued for breach of contract, requested specific performance and placed a notice of lis pendens on the property. The sellers asserted defenses based on the

See* NINE-YEAR CLOSING *page 8

Nine-Year Closing *from page 7*

alleged abandonment of the contract, waiver, repudiation and laches, and counterclaimed for breach of contract. After extensive discovery, the buyer obtained a partial summary judgment that dismissed the sellers' affirmative defenses. After more discovery, the buyer obtained summary judgment on the issue of the sellers' liability for breach, and the trial court awarded specific performance on the condition that the purchase price would be the land's value as determined by the appraisal but without any off set based on the property's diminished value due to contamination or for the cost of any environmental remediation. The sellers appealed, and in an unpublished opinion, the Court of Appeals affirmed in part but reversed in part. The buyer petitioned for a rehearing, which was granted. In December 2009, the Court of Appeals issued a published opinion that superseded its first opinion, and affirmed in all respects the summary judgment rulings in favor of the buyer. The sellers did not appeal further, and in March 2010 – fully nine years after the original closing date – the sale was consummated and the buyer became the owner of the property.

Time Is Of The Essence – Except When It's Not

In affirming the award of specific performance, the Court of Appeals first addressed the contract's time-is-of-the-essence clause. If it still applied, as the sellers argued, then the failure to close in March 2001 would have doomed the buyer's effort to enforce the contract nearly five years later. The sellers argued that, at a minimum, an issue of fact existed as to whether the sellers had waived the time-is-of-the-essence clause. The buyer argued, and the court agreed, that the sellers impliedly waived the clause as a matter of law.

The admitted or undisputed facts showed that, prior to the original deadline for closing, the sellers did not tender a recordable deed and other necessary seller documents. Although the sellers and their closing attorney testified in deposition that, one month after the closing date, they believed the deal was dead, the sellers never told the buyer that they were insisting on the closing date specified in the contract. Nor did they inform the buyer that they deemed the contract terminated for failure to close. Instead, one of the sellers testified that, after the original closing date had passed, she expected the closing to occur a month or two later, i.e., long after the contract's specified closing date.

In addition, once the Phase II environmental report was completed, the sellers sought permission for their environmental consultant to contact the buyer's consultant to discuss the condition of the property, and sellers' consultant performed its own tests on the property. The sellers' agent then wrote the buyer about "the sale and purchase of the property," discussed the efforts undertaken by the sellers' environmental consultant and promised that "We will communicate with you as time goes by." Nine months after the original closing deadline, the agent forwarded another letter to the buyer, again regarding "the sale and purchase of the property," in which he described the results of sellers' environmental investigation, promised a copy of their consultant's report in the near future, and stated that the sellers intended to put the property into the DSCA program.

Consequently, the Court of Appeals' ruled that waiver of the time-is-of-the-essence clause occurred as a matter of law: "These undisputed facts demonstrating that defendants not only never insisted on closing on the specified closing date, but made statements and took actions manifesting an intent that closing should occur at some unspecified later date establish that defendants waived the 'time is of the essence' clause. The undisputed facts establish conduct that naturally would lead [the buyer] to believe that [the sellers] had dispensed with their right to insist that time was of the essence with respect to closing on the property." **Phoenix**, 688 S.E.2d at 723 (citations omitted).

The Sellers' Decision to Undertake an Additional Performance – Why The Closing Clock Never Started Ticking

So, when did the parties have to close, and how could the buyer compel a closing nine years after the original closing date? The answer lies in the sellers' own conduct. Just as the sellers' conduct waived the time-is-of-the-essence clause, the sellers' conduct in undertaking to clean up the property extended the closing date. In the usual case, in the absence of a time-is-of-the-essence clause, the buyer and seller have a reasonable time after the closing date to complete performance. The sellers argued that the buyer, by waiting until August 2004 to seek a closing, had waited an unreasonably long time to close. The buyer argued, and the Court of Appeals agreed, that the land's contamination and the sellers' incomplete efforts at remediation meant that the "reasonable time doctrine" never even came into play.

Clearly, the contract did not expressly require the sellers to clean up the property. Just as clearly, however, the contract contained environmental warranties and an indemnification regarding the property's environmental condition. By their conduct, the sellers indicated to the buyer that they had elected to clean up the property rather than reduce the purchase price due to their liability for any contamination found on the property. It was undisputed that the sellers actually undertook, for a time, to address issues of remediation of the contamination. The sellers hired their own environmental consultant, told the buyer they were conducting an environmental investigation, notified the buyer of the results of the investigation, and stated they were enrolling the property in the State's DSCA program. All of this "coupled with the fact that an environmental cleanup could take years to complete, indicated to [the buyer] that [the sellers] still intended to perform under the contract despite the passing of the original closing date." *Id.* at 725.

The fatal flaw in the sellers' argument was that they presumed that the reasonable time for performance should be calculated from the original closing date. The Court of Appeals rejected this argument and, following a case from the Supreme Court, ruled that in order for the clock to start ticking on the reasonable time frame, the sellers were required to notify the buyer that they had completed their cleanup and were ready and able to perform. Because the evidence was undisputed that the sellers never notified the buyer that they were ready and able to perform, the reasonable time for the buyer's performance never began. *Id.* (following **Fletcher v. Jones**, 314 N.C. 389, 333 S.E.2d 731 (1985)).

A Seller Should Have Only One Buyer

Because of the unresolved issue of the cleanup of the property, neither the buyer nor the sellers were required to close in the summer of 2004. Nor were they free to walk away from each other – even though the parties had not communicated with each other in nearly three years. At this point, the buyer had not abandoned the contract and the sellers were not discharged from their obligation to deliver a deed. The sellers mistakenly concluded the opposite. Because the sellers informed the buyer that the property was back on the market at a higher price and then put the property under contract

with a second buyer, the sellers anticipatorily repudiated the contract. At that point, the buyer was free to immediately sue and was not required to tender the purchase price. *Id.* The court therefore affirmed the summary judgment as to the sellers' liability for breach of contract.

The Nine-Year Closing

The sellers also argued that their affirmative defense of laches should not have been dismissed, claiming that the buyer's three-year delay in asserting its claim constituted laches. As the court noted, laches "requires proof of three elements: (1) the delay must result in some change in the property condition or relations of the parties, (2) the delay must be unreasonable and harmful, and (3) the claimant must not know of the existence of the grounds for the claim." *Id.* at 726. The mere passage of time will not support a finding of laches, and the sellers offered no evidence that the buyer's delay in filing suit resulted in a change in the property's condition or the relations of the parties. Instead, the sellers argued that they were prejudiced by delay because the property's value increased as a result of the Raleigh Convention Center being located across the street from the property. The court rejected this argument because the "increase was fortuitous and not due to any action taken by [the sellers] during the delay that increased the value of the property. Any prejudice suffered by [the sellers] did not arise out of the delay in [the buyer's] bringing suit, but rather arose out of the contract's provision that the property would be valued as of the exercise date of the option." *Id.*

Because of the decision by the Court of Appeals, the buyer was entitled to specific performance. Several months after the decision, a closing occurred in which the sellers delivered a general warranty deed and the buyer delivered the purchase price of $947,500. Thus, because of the nine-year closing, the buyer was able to purchase the property in 2010 based on the property's fair market value in 2000.

So What's A Seller (And Its Counsel) To Do?

The combination of facts in the **Phoenix** case was unusual, but the actions taken by the parties, and the legal effect of those actions, offer several important points for real estate practitioners to consider whenever issues arise that could delay a closing:

- If the contract specifies that time is of the essence, the parties should act as if that is the case. In other words, if the parties do not treat deadlines as critical, do not expect a judge will do so.

- A course of performance that varies from the strict terms of the contract can result in a significant alteration of the parties' rights and obligations. Counsel needs to seriously study the legal effect of the course of performance and advise the client accordingly.

- Where environmental issues arise, counsel for the seller should advise his or her client to expect that the closing will be delayed, possibly for years, and to act accordingly.

- Undertaking a performance not expressly required by the contract can have important legal consequences. In **Phoenix**, the sellers could have opted to reduce the purchase price, which would have avoided the lengthy delay in closing, the mistaken assumption that the buyer had abandoned the contract, and the decision to sell the property to a second buyer while the land was still under contract with the first buyer.

- After issues arise that could lead to litigation, consider carefully the role of a real estate agent in communicating with the other party. Counsel may decide that all communications should go through him or her, and that no communications should be handled by the client's real estate agent without counsel's prior input.

- Do not assume that a failure of the parties to communicate, even for a long period of time, means that the contract has been abandoned. Abandonment requires clear and con vincing evidence and it may not be possible to satisfy that higher eviden tiary standard with only evidence of non-communication.

- Do not assume that a seller is free to sell the property to someone else merely because of the buyer's silence. The decision to sell the property to a second buyer should be made carefully, and preferably only upon written evidence of a buyer's unequivocal repudiation, a written agreement to terminate the first contract, or via a back up contract in which the sale to the second buyer is made expressly conditional upon the termination of the first contract.

- If a seller believes that it is truly ready and able to perform – and wishes to put the burden on the buyer to close and pay the purchase price – the seller's counsel should notify the seller's counsel that the seller is ready to perform, and then deliver to the buyer's counsel to hold in trust an original of a properly executed and notarized deed that can be recorded, along with all other seller documents that are customary or expressly equired by the contract.

- If a buyer expects to close, but believes closing may be delayed for a considerable time or that litigation is possible, the buyer must ensure that the funds needed to pay the purchase price are reserved or are guaranteed to be available throughout the lengthy closing process and the life of the litigation.

One final thought occurs, perhaps due to a personal bias, but one still worth considering: when an issue arises that may signal a lengthy delay in closing and possibly litigation, the transactional attorneys on each side of the deal would likely benefit from consulting with a litigator to assess the client's rights and obligations and assist in crafting a strategy that either results in a closing and avoids litigation altogether, or at least avoids pitfalls that can impair the client's case once litigation begins. ■

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Real Property

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Buyer Beware

Determining Liability When the Deal Falls Apart

By Scott A. Miskimon

Closing is months away and the buyer asks for a *fourth* extension of the closing date. The seller throws up his hands at the buyer's endless delays and indecision, and under a mistaken belief that the third extension of the closing date has expired, faxes a letter demanding a closing *now* or the deal is *off*. Should the buyer's closing attorney step in and try to coax the seller to close? Or should the buyer immediately file suit? And what should the seller's attorney do, particularly if in the meantime the seller agrees to sell the land to someone else?

North Carolina's appellate courts recently decided the case of **Profile Investments No. 25, LLC v. Ammons East Corporation**, 2010 N.C. App. LEXIS 1856, 700 S.E.2d 232 (2010), *disc. rev. denied*, 2011 N.C. LEXIS 247, 707 S.E.2d 240 (2011), and it illustrates the difficulties facing a buyer who believes the seller will not close. Although the plaintiff buyer sued claiming the seller had breached the agreement by reason of a written repudiation and by contracting to sell the property to someone else, the ultimate ruling was that, because of the buyer's conduct, as a matter of law the seller did not breach the contract. The case offers important lessons for counsel representing buyers and sellers, particularly regarding transactions that have been long delayed and where mutual trust no longer exists.

The Deal

In **Profile**, the seller was a North Carolina corporation that owned a seventeen-acre tract of undeveloped land located in southeast Raleigh. The buyer was a single-purpose limited liability company, owned by a Kentucky developer who is also a licensed attorney practicing commercial real estate law. In June 2005, the parties entered into a written purchase and sale agreement. The buyer wanted to develop the land into a strip shopping center anchored by a grocery store. The original closing date was set for December 2005, but the buyer repeatedly requested that the seller grant extensions of time, which it did, and the parties signed three written amendments to the agreement. Consequently, the closing date was extended to July 31, 2007.

The buyer's requests for extensions of the closing deadline were prompted because the buyer wanted more time to market its planned shopping center and line up buyers of outparcels, and most especially, an anchor tenant. In May 2007 – two years after the agreement was first signed – the buyer's broker called the seller and asked for a fourth extension, claiming the buyer needed more time beyond the July 31, 2007 closing date. The seller did not grant this request.

The Seller Seeks a Closing

The seller had long been dealing with a buyer who was unready or indecisive, and who would soon prove inconsistent. Moreover, by mistake the seller believed that June 1, 2007 – rather than July 31, 2007 – was the buyer's deadline to close. In actuality, June 1 was the end of the buyer's due diligence period. Under this mistaken belief as to the closing date, the seller faxed a letter to the buyer's broker to prod the buyer to close. In this letter, the seller's president noted his understanding of the deadline for closing, expressed his frustration about not being able to get a definite date for a closing or confirmation that the seller would in fact close, and stated that "unless you make some other arrangements with me immediately I will consider this Contract null and void on June 1, 2007." The buyer did not respond to this fax and the seller's president sent the letter again one week later indicating that if the deal did not close by June 4, 2007, the seller would consider that the agreement with the buyer would "no longer exist." The parties then spoke and the buyer indicated that the seller was free to sell the property to someone else. Reasonably enough, the seller soon put the land under contract with a second buyer.

The Buyer's Conduct After the Seller's Purported "Repudiation"

The day after that, however, the original buyer reversed course and its broker told the seller that the original buyer would close. Caught by surprise due to the buyer's inconsistency, the seller reasonably reacted to the dilemma of having two buyers by promptly contacting the second buyer and requesting a termination of their contract. A termination was not immediately agreed to, and by mid-June, the deadline for closing with the original buyer was still six weeks away. With the buyer's knowledge, the buyer's closing attorney then sent a letter to the seller stating that "the Buyer is moving forward towards closing on or before July 31, 2007. The Buyer is ready, willing and able to proceed to Closing pursuant to the terms of the Contract." The closing attorney emphasized this point with a sentence that she underlined stating that "the Buyer is ready, willing and able to close the transaction . . . on or before July 31, 2007." The seller's closing attorney responded that the seller was going to write a letter to confirm that the parties' agreement was still in effect and that the seller would close.

The buyer then changed course again and requested that the seller sign a memorandum of contract that would be recorded in order to prevent the seller from selling the land to someone else. The seller

Beware, *continued from page 33*

rejected the document as drafted by the buyer because it did not merely re-state the terms of the purchase and sale agreement, but significantly altered the buyer's duty to close. The seller requested that the memorandum of contract be re-drafted to delete objectionable language. The buyer would not agree to do so. Instead, a few days later the buyer sued for breach of contract and requested specific performance and damages.

At this point the deadline for closing was still five weeks away. A few days after the lawsuit was filed, the seller's president obtained a written agreement with the second buyer to terminate their purchase and sale agreement, which was crucial in allowing the seller to go to closing. The seller's counsel then confirmed for the buyer via email that the seller would close. The buyer's closing attorney replied that she would contact her client and respond with a closing date; she also asked the seller to provide a draft of the deed and other seller documents. The seller complied, sent the draft documents, but also repeatedly asked for a closing date. None was provided. On July 31, 2007 – the deadline for closing – the seller delivered to the buyer's closing attorney an executed deed and other seller closing documents. The same day, the buyer rejected the deed and refused to close. One month later, the buyer amended its complaint as of right and dropped its request for specific performance. Thereafter, the buyer pursued its claim for breach but sought only money damages. The buyer originally estimated its damages at $2.7 million, but later revised its estimate to $6.9 million.

The Twists and Turns in Four Years of Litigation

Litigation over the buyer's claim for damages required extensive discovery and generated a host of motions. A few months after filing suit—and after the buyer and its brokers had been deposed—the buyer moved for summary judgment as to the seller's purported liability for anticipatorily repudiating the agreement. The seller then filed its own motion for partial summary judgment to dismiss the buyer's claim and to have the buyer found liable for breaching the agreement due to the buyer's rejection of the deed that was timely delivered to it. The trial court denied the cross-motions for summary judgment. The seller later moved for summary judgment on the issue of lack of proximate cause, which was also denied. The seller was successful in obtaining an order that compelled the buyer to fully explain its revised damages theory and calculation of $6,900,000. Plaintiff failed to comply with this order, however, and the trial court sanctioned the buyer by excluding the revised damages theory, limiting the buyer to its original $2,700,000 damages theory, and ordering the buyer to pay the seller $11,000 in attorneys' fees. The seller then filed a third motion for partial summary judgment on the grounds that, even assuming that the seller breached, all of the buyer's alleged damages could have been avoided if the buyer had closed when the seller timely delivered a deed to the buyer. This motion was granted, the buyer appealed, and the seller cross-appealed the denial of its first two motions for partial summary judgment.

The Buyer Loses its Lawsuit Because of its Own Conduct

On appeal, the seller won and the buyer lost—but not because of the buyer's failure to mitigate its alleged damages (the third motion for summary judgment). Instead, the North Carolina Court of Appeals ruled that the trial court erred in not granting the seller's first motion for partial summary judgment because, as a matter of law, the buyer had not treated the seller's conduct as a repudiation of the contract.

So what did the buyer do to lose its case? In order to prove anticipatory repudiation, a plaintiff must show an absolute and positive refusal to perform the contract prior to the date on which performance is due. Whether the letter from the seller's president was a repudiation or a mere mistake as to the actual deadline for closing turned out to be a moot point. The Court of Appeals expressly chose not to address that issue. Far more important was the fact that, after receiving the seller's letter, "the undisputed statements and actions of [the buyer] make it clear that [the buyer] did not treat the letter as a repudiation." The Court of Appeals then followed – and extensively quoted – a case from the North Carolina Supreme Court decided nearly a century ago. In particular, the Court of Appeals followed the rule that an anticipatory repudiation "is not a breach of the contract *unless it is treated as such by the adverse party*.' " **Profile**, 700 S.E.2d at 236 (quoting **Edwards v. Proctor**, 173 N.C. 41, 44, 91 S.E. 584, 585 (1917)) (emphasis added).

The Court of Appeals then summarized the reasons why the buyer lost. After receiving the letter that supposedly "repudiated" the contract, the buyer's closing attorney sent the seller a letter demanding that the seller proceed with the contract or be sued. In the buyer's letter, the buyer repeatedly emphasized that it was "ready, willing and able to close" by the stipulated closing date. Although the buyer sued for specific performance of the contract, it continued to inform the seller that it intended to close in accordance with the contract and requested that the seller provide closing documents. Consequently, the buyer's "actions and statements clearly demonstrated that [the buyer] was planning on proceeding with the contract and [it] did nothing to treat [the seller's letter] as a repudiation until [the seller] tendered the deed. Only upon tender of the deed did [the buyer] change its course, and after refusing to accept the deed it had demanded, dropped its claim for specific performance. As [the buyer] did not treat [the seller's] letter as a repudiation, the contract was never breached." **Profile**, 700 S.E.2d at 238.

In light of its ruling, the Court of Appeals remanded the case with orders that the trial court enter a summary judgment in favor of the seller. The buyer further appealed this decision, but the Supreme Court declined to hear the buyer's appeal.

Lessons for a Buyer

Cases like **Profile** involve difficult decisions for buyers and sellers, and their counsel. Where a buyer believes the seller will not or cannot close, but the closing date has not yet arrived, the key initial questions for the buyer are whether the seller has anticipatorily repudiated the

contract, and if so, what proof of repudiation exists. Although anticipatory repudiation need only be proved by a preponderance of the evidence, for a statement or conduct to qualify as a repudiation, it must be a "positive, distinct, unequivocal, and absolute refusal to perform the contract." **Edwards**, 173 N.C. at 44. When an anticipatory repudiation occurs, the plaintiff must choose between two paths: either (1) elect to treat the repudiation as a breach and sue immediately, or (2) elect to ignore the repudiation and proceed with a performance of the contract. A plaintiff cannot do both. *Id*. at 44-45.

Given these choices, and the standard for proving anticipatory repudiation, a buyer faces several challenges and risks. A buyer who claims the seller repudiated and immediately sues the seller runs the risk of being wrong on the issue of repudiation, and putting itself in breach. If the buyer ignores the purported repudiation and instead demands that the seller close, or otherwise acts as if the buyer will perform, the buyer is no longer in a position to claim breach. Consequently, the buyer should not sue prior to the closing date, and must instead proceed with performing its obligations due at closing. If the seller does not deliver a deed at closing, and if the contract does not provide that time is of the essence, then the buyer still cannot claim the seller is in breach. Instead, the buyer must tender payment to the seller's closing attorney to be held in escrow, and give the seller some "reasonable" amount of time to perform. **Fletcher v. Jones**, 314 N.C. 389, 393, 333 S.E.2d 731, 734 (1985). What will constitute a reasonable time will not be known in advance, and will usually only be decided by a jury.

Thus, if a buyer wants to avoid this latter situation, and believes that the seller cannot or will not close, the buyer should either sue immediately after receiving evidence of the anticipatory repudiation or declare in writing that the contract is at an end and that the buyer no longer has any obligation to perform. As to either course of action, however, the buyer should only do so if the seller's repudiation is crystal clear, is in writing, and the buyer and its closing attorney and broker have not taken any action or made any statement to suggest that the buyer is not treating the seller's statement or conduct as anything but a repudiation.

Lessons for a Seller

The seller and its counsel may also face hard choices depending on what actions the seller has taken. If the client has either repudiated the contract or made a statement that might be construed as a repudiation, seller's counsel should determine whether the client is willing to retract the statement and proceed with closing. Because a timely retraction will cut off the buyer's right to immediately sue the seller, the seller's counsel should immediately send a written retraction so that the buyer receives it before any lawsuit is filed. *See* **Nazarro v. Sagun**, 2009 N.C. App. LEXIS 986, at *15-16, 680 S.E.2d 270 (June 16, 2009) (unpublished) (citing RESTATEMENT (SECOND) OF CONTRACTS § 256), *disc. rev. denied*, 2009 N.C. LEXIS 790, 682 S.E.2d 385 (2009). The retraction should include clear and unconditional assurances that the seller intends to timely and properly perform his contract and close per the terms of the agreement. *See* **Homeland Training Ctr., LLC v. Summit Point Automotive Research Center**, 594 F.3d 285, 296 (4th Cir. 2010).

Providing an immediate and unequivocal retraction may not be possible, however, if the seller, under the belief he was free to sell the property to someone else, agreed to sell the land to a second buyer. Independent of any statement from the seller to the original buyer, the act of contracting to sell the property to a second buyer may be deemed to be an anticipatory repudiation of the original contract. *See, e.g.*, **Phoenix Ltd. P'ship of Raleigh v. Simpson**, 201 N.C. App. 493, 505-06, 688 S.E.2d 717, 725 (2009). If the seller finds himself in the position of having contracts to sell the same land to two different buyers, the seller is at risk of being a defendant in two different lawsuits. Therefore, if the client desires to retract his purported repudiation and close with the original buyer, the seller's counsel will first need to negotiate a rescission of the second contract. Without such a rescission, a seller's retraction and assurances of closing under the first contract would not be credible or effective. Thus, the second contract must be nullified in order for the seller to be in a position to close with the original buyer as well as eliminate potential liability to the second buyer. If the seller has doubts that the original buyer will close, the seller should consider entering into a backup contract with the second buyer; this agreement would both rescind the contract with the second buyer and also preserve the relationship, albeit contingent upon the original buyer not closing by a stated deadline.

Conclusion

With the uncertainties facing a buyer and a seller when a deal starts to unravel, the closing attorney for each side has to carefully assess the client's rights and obligations. This analysis cannot be based solely on the language of the contract, but has to take into account the statements and conduct of the client, the other party, and of the brokers and closing attorneys themselves. Further, where an anticipatory repudiation is claimed, litigation could be imminent and may be necessary in order to preserve rights. Consequently, the client may well be best served by having the closing attorney immediately consult with a litigator to analyze the client's situation and develop a strategy that avoids missteps, minimizes risks, and advances the client's objectives. •

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the Business Lawyer

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"Recovering Attorneys' Fees: A New Day Dawns in North Carolina"

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Recovering Attorneys' Fees
A New Day Dawns in North Carolina

By Scott A. Miskimon

For businesses in North Carolina long frustrated at the inability to recover attorneys' fees in contract disputes that go to court, a new day has dawned. North Carolina recently enacted a statute that expands the opportunity to recover attorneys' fees incurred in business contract litigation, and the new law may dramatically alter the costs of litigating contract disputes and affect decisions to either litigate or settle.

How does the new law work?

General Statutes section 6-21.6 applies to all "business contracts" entered into on or after Oct. 1, 2011. The statute gives a judge or arbitrator the discretion to award attorneys' fees if the business contract at issue contains a "reciprocal attorneys' fees provision." The statute does not require an attorneys' fees provision in business contracts, but if the parties elect to include such a provision, it must state that each party agrees to pay the other party's attorneys' fees and expenses that were incurred by reason of any suit, action, proceeding or arbitration involving the business contract.

The new law applies to a business contract, which is defined as "a contract entered into primarily for business or commercial purposes." Certain types of agreements are explicitly excluded from the scope of the statute. Consumer contracts (involving individuals and which are primarily for personal, family and household purposes) are outside the statute. Also excluded are employment contracts, which are defined as personal services agreements made with an individual who performs services, either as an employee or independent contractor. Business contracts also do not include contracts made with the State or with any State agency.

Many types of agreements will now be subject to an award of attorneys' fees if they contain a reciprocal attorneys' fees provision. These will include contracts between businesses for services, for the sale or lease of goods (products and equipment), commercial real estate contracts and leases, construction contracts, asset purchase agreements, stock agreements, corporate shareholder agreements and operating agreements for limited liability companies.

Under the new law, the judge or the arbitrator has the discretion whether to award attorney fees at all, and the amount of fees to award. Decisions to award fees are to be based on "all relevant factors." The new law provides a list of thirteen non-exclusive factors, such as the terms of the contract, the extent to which the party asking for attorneys' fees prevailed in the action, the amount in controversy, the amount of damages awarded, the reasonableness of the amount of fees requested, the relative economic circumstances of the parties, and the timing and amount of settlement offers. Interestingly, it is not an absolute requirement that a party win the case in order to recover its attorneys' fees.

The statute has a notable quirk to it: the business contract must be "signed by hand" by all the parties to it. Consequently, contracts formed electronically with electronic signatures would prevent the parties from recovering attorneys' fees. The intent behind this provision is to prevent unfairness and surprise in internet-based "click accept" contracts, but it appears to undercut existing state law regarding electronic contracting.

How is the new law different than an earlier statute?

For a business contract that contains a reciprocal attorneys' fees provision, all parties to the business contract will have the potential to recover attorneys' fees. This is a significant expansion of North Carolina law. Under an already existing statute (N.C.G. S. § 6-21.2), certain types of contracts can allow for the recovery of attorneys' fees. This earlier statute has not been repealed and remains a viable alternative for recovering attorneys' fees if the contract qualifies as an "evidence of indebtedness" and provides for the recovery of attorneys' fees. Promissory notes and commercial leases qualify as evidences of indebtedness, but the recovery of attorneys' fees is not reciprocal. For example, in a case involving the breach of a commercial lease, under the existing statute only the landlord may recover attorneys' fees; a tenant may not. By contrast, because of the new law's explicit requirement of mutuality, all parties to a business contract that contains a reciprocal attorneys' fees provision will be entitled to seek attorneys' fees.

What amount of attorneys' fees can be recovered?

The amount of attorneys' fees that can be recovered is not specified in the new law. For example, under the earlier statute, attorneys' fees can be based on a fixed percentage of 15 percent of the amount owed under the "evidence of indebtedness." By contrast, the new law prohibits recovery of fees based on any stated percentage. The only limit on fees is that, if the case involves primarily a claim for money damages (as opposed to an injunction), the amount that a court or arbitrator awards cannot exceed the amount of monetary damages that are awarded.

Conclusion

Although the courts have not yet been called on to apply and en-

force the new law, the language of the statute suggests that companies should carefully consider the following when drafting a business contract that contains a reciprocal attorneys' fees provision:

• If there is a dispute over the business contract, how expensive will litigation of that dispute likely be?

• How will the cost of litigation compare to the amount of damages that will likely be at issue?

• What is the company's risk tolerance for paying damages, its own attorneys' fees and the attorneys' fees of its opponent?

• Is reciprocity desirable? If the contract is likely to qualify as an evidence of indebtedness under the earlier statute, does the company give up its leverage if it agrees to a reciprocal attorneys' fees provision under the new law?

• Because the new law makes the terms of the contract a factor to consider when awarding attorneys' fees, businesses should consider including provisions to clarify the circumstances under which the parties intend attorneys' fees to be recoverable. Such provisions could include language that makes clear that only a prevailing party may recover attorneys' fees, and that a successful defense of a claim will entitle the defendant to recover its reasonable attorneys' fees.

As these points suggest, the new law hands businesses a powerful tool that may affect whether and how contract disputes are resolved. Therefore, new business contracts should be evaluated in light of this new law and drafted to either limit exposure or create greater leverage for resolving disputes that may arise. Businesses should also carefully consider the impact of the new attorneys' fees statute on their existing standard form contracts and revise them accordingly. •

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Client Alert

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MORE INFORMATION

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PRACTICE AREAS

Complex Contract Disputes

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Risky Business: The Dangers of Contracting with Municipalities

A private company may eye a potential contract with a North Carolina county or city as a lucrative opportunity, but contracting with a municipality has its dangers. A contractor may think it is protected because it has a signed contract—and may even fully perform it—only to find out that there is no valid contract, the municipality cannot be held liable for breach, and the contractor will not be paid. This harsh and surprising result occurs because the municipality failed to comply with the statutory requirement of a "pre-audit certificate." When a county or city enters into a contract that creates a monetary obligation in the municipality's current fiscal year, the county or city must sign a pre-audit certificate in order for there to be a valid contract—and hence a right for the contractor to be paid.

The requirement of a pre-audit certificate is found in General Statutes section 159-28(a), part of the Local Government Budget and Fiscal Control Act. The law requires a written certificate, signed by the municipality's finance officer, stating that "This instrument has been pre-audited in the manner required by the Local Government Budget and Fiscal Control Act." This law is intended to ensure that contractual obligations incurred by a municipality are appropriated and that the municipality has sufficient funds to pay the financial obligations that are due in the current fiscal year. If the pre-audit certificate is not included, the contract or purchase order is invalid and cannot be enforced. This requirement applies to any county, town or city, as well as any board, agency, commission, or institution of a county, town or city. A different law imposes a similar requirement on contracts with school boards.

The recent North Carolina Court of Appeals case of *Charlotte Motor Speedway v. County of Cabarrus*, ___ N.C. App. ___, 748 S.E.2d 171 (2013), drives home the point that it can be very risky to do business with a municipality on an informal basis. The Lowes Motor Speedway threatened to leave Cabarrus County unless the county paid for infrastructure improvements to accommodate both its existing race track and a planned drag strip that would be built nearby. Cabarrus County and the City of Concord sent the Speedway's CEO a letter stating that they were "committed to providing $80,000,000" for "the financing, design and construction of road, pedestrian, utility and noise attenuation projects." Of that amount, $20,000,000 would have to be funded by the State of North Carolina, but, if that could not be done in three years, the County "pledged to provide it from other sources."

The letter closed by noting that "all parties anticipate that the $80,000,000 will be formalized in an agreement . . . ." Both the city's mayor and the chairman of the County Commission signed the letter. After the Speedway's CEO received it, he called the mayor and told him "we have an agreement." No formal contract was signed, and the County's finance officer did not sign a pre-audit certificate. Nevertheless, the Speedway built its drag strip at a cost of $60,000,000 and spent another $4,000,000 on public infrastructure improvements near the Speedway. Once this construction work was completed, the County tendered a formal written agreement which the Speedway rejected as having terms to which it had not agreed. The Speedway filed suit against the County seeking to recover damages, but its case was dismissed.

The Court of Appeals affirmed the dismissal, finding that the letter was not a valid contract but merely an agreement to agree with terms that were too indefinite to be enforced. The parties argued over the issue of a lack of a pre-audit certificate, but the Court of Appeals decided to reach the merits of the plaintiff's contract claim rather than dismiss the case on a statutory technicality that some might say unfairly penalizes contractors who deal in good faith with municipalities. The Speedway has further appealed its case to the North Carolina Supreme Court, where it faces a major hurdle: even if the County's letter is an otherwise valid contract, there is no pre-audit certificate.

If the Speedway loses its final appeal, it will be in good company. Contractors have been on the losing end of the statute since it was enacted, and in recent years there have been a spate of cases in which contractors have lost and counties and cities have triumphed. For example, in another 2013 case, *Howard v. County of Durham*, ___ N.C. App. ___, 748 S.E.2d 1 (2013), the Court of Appeals affirmed the dismissal of a claim brought by a former employee for breach of a settlement agreement entered into with a county. The courts have used the statute to nullify a broad variety of other types of contracts, including contracts to buy real estate, equipment leases, employment contracts and other service agreements, contracts for post-employment benefits, contracts to issue permits, and contracts agreeing to allocate a percentage of profits. The statute has been applied regardless of whether the contract is in writing or is a verbal agreement. Because any person contracting with a municipality will be charged with knowledge of the statute's requirement, as well as the duty to prove compliance if the agreement is the subject of litigation, familiarity with the statute is essential.

Strict compliance with the statute is required. A contract is void if the pre-audit certificate was included with the contract but was not signed. Having the county manager sign is not good enough—it has to be the finance manager. Although a pre-audit certificate is not required when the municipality's obligation to pay money will arise in future fiscal years, the entire contract is invalid if at least some of the obligation will be incurred during the fiscal year in which the agreement is made.

If the municipality does not comply with the statute, the loss will fall on the contractor with whom it did business. A claim for money damages will fail and the municipality will be protected from liability under the doctrine of sovereign immunity. Normally, a municipality waives sovereign immunity—and consents to being sued for breach of contract—when it enters into a *valid* contract. But if the contract is invalid because no pre-audit certificate was signed, the municipality has not waived its sovereign immunity. The contractor who has fully performed its contract and now wants to be paid will get no relief if the municipality raises the pre-audit certificate defense. Alternative theories such as estoppel or unjust enrichment will fail just as certainly as a breach of contract claim. The law will not allow a contractor to obtain compensation indirectly through a non-contract claim when the statute directly forbids recovery of damages through a contract claim.

Charlotte Motor Speedway reminds us that, when a contract with a municipality creates a monetary obligation in the current fiscal year, it is vital that the contractor stay its hand and does not perform unless and until it has a formal written contract signed by the municipality that clearly lays out all of the terms of the parties' agreement *and* it has a pre-audit certificate signed by the municipality's finance officer. Failing to obtain both could leave the contractor

holding the bill for goods or services it provided to a city or county.