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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

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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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