Commentary

California Supreme Court Rules on Whether Purchase Agreement is an Unenforceable Option Agreement; Overrules *Steiner v Thexton*

by McKenna Long & Aldridge LLP

That gust of wind you might have just felt was actually the collective sighs of relief of developers and their attorneys, after the California Supreme Court decision in *Steiner v. Thexton* on March 18, 2010, case number S164928. In this case, the California Court of Appeals had ruled that, notwithstanding substantial expenditure by Buyer to subdivide Seller's property, the "purchase" contract was a revocable offer. As such, it could not be enforced if revoked by Seller before Buyer paid the purchase price.

Steiner, a developer, and Thexton entered into an agreement for Steiner to purchase a 10-acre portion of Thexton's 12-acre parcel after Steiner pursued approvals for a parcel split and development permits. Steiner was not obliged to do anything, and could cancel the transaction at any time "at his absolute and sole discretion." Steiner subsequently spent tens of thousands of dollars pursuing the approvals. After the tract application was filed, Thexton refused to sell and asked for cancellation of escrow. Steiner sued for specific performance. The lower courts (Trial and Appellate) determined that Steiner's ability to cancel "at his absolute and sole discretion," while Thexton was required to hold the property for Steiner's purchase for three years, constituted an option without consideration and was unenforceable.

The Supreme Court affirmed the lower court rulings that the contract was an option (seller agreed to hold an offer open while buyer pursued entitlements and investigated the property) and that the obligations of Steiner may have been illusory at the time the agreement was entered into (Buyer had an absolute escape). However, the Court overturned the Court of Appeals, holding that Buyer's part performance in this case (Buyer actually pursued the approvals) constituted sufficient and bargained-for consideration to make the option irrevocable, and thus the contract was enforceable.

"Free Looks" are Options (Unilateral Agreements)

Steiner v. Thexton reaffirms that agreements which give buyers the right to terminate for any reason or no reason and which do not include bargained-for consideration from the buyers are unilateral option agreements, which may be terminated by sellers at any time prior to buyers' full performance (i.e., prior to closing).

Part Performance of a Bargained for Obligation is Sufficient Consideration

California statute defines consideration as a benefit conferred, or agreed to be conferred, upon the other party or a prejudice suffered, or agreed to be suffered, by the party, as an inducement to the other party. The Supreme Court reiterated that it is not

enough to confer a benefit or suffer a prejudice. There is a second requirement that the benefit or prejudice "must actually be bargained for as the exchange for the promise."

In order for the Seller in *Steiner v. Thexton* to retain 2 acres of the property (out of the 12 acre parcel), the property had to be subdivided and there was evidence that Seller expected Buyer to pursue the necessary approvals. The Court held that as a matter of law Buyer's part performance of the bargained-for promise to seek a parcel split created sufficient consideration to render the option irrevocable.

Practice Points

- *Steiner v. Thexton* is a confirmation that "free look" agreements (i.e., without consideration) are unilateral options that can be revoked by sellers. ***Parties negotiating Option Agreements and Purchase Agreements should consult with counsel to provide for sufficient consideration to make the agreements enforceable.*** Similarly, parties interpreting existing agreements should consult with counsel regarding whether the agreements are enforceable in view of *Steiner v. Thexton*.
- The Supreme Court made reference to, but did not decide, various issues including whether an initial deposit into escrow constitutes consideration based on the buyer's loss of use of those funds; whether the outcome of *Steiner v. Thexton* would have been different if the entitlement work performed by the buyer had been exclusively in its own interest; and whether the legal theory of promissory estoppel would have required enforcement of the agreement.

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