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Steiner v. Thexton: The California Supreme Court Considers the Consideration

Author: [Matthew S. Urbach](#) | [Justin X. Thompson](#)

On March 18, 2010, the California Supreme Court reversed the Court of Appeal's judgment in *Steiner v. Thexton*, an opinion issued in May 2008. In *Steiner*, the Court of Appeal held that an agreement containing a contingency allowing the buyer the sole and absolute discretion to terminate the agreement if the buyer was unable to obtain entitlements for the development was "really an attempt to create an option agreement," which failed for lack of consideration. In overturning the Court of Appeal's decision, the Supreme Court agreed with the lower court that the agreement was an option – not a bilateral sales agreement - but held that sufficient consideration existed to render the option irrevocable.

In *Steiner* the buyer was a real estate developer who wanted to develop several houses on a 10-acre portion of the seller's 12.29-acre property. Pursuant to the terms of a September 4, 2003 agreement ("Agreement"), the seller agreed to sell the 10-acre portion of his property to the buyer for \$500,000 by September 1, 2006, if the buyer decided to purchase the property after "expeditiously" pursuing county approvals and permits. The Agreement included a series of provisions stating the buyer would seek the necessary entitlements and permits, including a parcel split, for his proposed development. The provisions permitted the buyer to cancel the Agreement *at any time and in his sole and absolute discretion* before escrow closed. The Agreement further provided for automatic termination if the buyer did not obtain the requisite entitlements by September 1, 2006. Upon the opening of escrow, the buyer made a \$1,000 deposit "applicable toward [the] purchase price."

In October 2004, after the buyer had allegedly completed 75%- 90% of the work needed for county approval, the seller requested that the title company cancel the escrow. Notwithstanding the seller's expressed intention not to proceed with the Agreement, the buyer proceeded with the final hearing of the county's parcel review



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[Roger Grable](#)
Partner
rgrable@manatt.com
714.371.2537

[Bryan C. LeRoy](#)
Partner
bleroy@manatt.com

committee and succeeded in obtaining county approval for a tentative map. The buyer then filed an action for specific performance of the Agreement against the seller.

The Court of Appeal ruled that the Agreement was really a “disguised” option, not a purchase contract; although the seller was bound by the terms of the Agreement to sell on specified terms, the buyer had discretion as to whether he would buy the property. In affirming the trial court’s denial of the buyer’s right to specific performance, the Court of Appeal determined that the option was not supported by consideration. Because the attempt to create an option failed due to lack of consideration, the Agreement was, according to the Court of Appeal, “nothing more than a continuing offer to sell that could be revoked by [the seller] at any time.”

The California Supreme Court applied a two-pronged analysis to the lower court’s ruling. First, the Supreme Court determined that because the Agreement allowed the seller to terminate the Agreement at his sole and absolute discretion, the Court of Appeal correctly construed the Agreement as an option. The Supreme Court was quick to distinguish the subject agreement from the common form real estate contract, which binds both buyer and seller at the time of contracting even though certain contingencies, such as a loan or inspection contingency, allows one or both parties to terminate the agreement if the contingency fails. The Court reasoned that “withdrawal from such a contract is permitted *only* if the contingency fails. By contrast, the agreement here placed no such constraint on [the buyer].”

Second, the Supreme Court turned to the issue of whether there was adequate consideration to render the option irrevocable. The Supreme Court ruled that buyer’s “substantial efforts and expenditures to perform the bargained-for promise to seek a parcel split cured the initially illusory nature of the promise and rendered the option irrevocable.” Specifically, the Court held that buyer’s efforts and expenditure to obtain the parcel split constituted both a benefit to the seller and prejudice to the buyer and, under the facts of the case, were bargained for in exchange for the seller’s promise. Although the Court’s conclusion was based upon the buyer’s part performance of the promise to obtain a parcel split, the Court suggested that because seller “gave up use” of his \$1,000 deposit for three years, the deposit alone could constitute “bargained-for prejudice.” The Court, however, declined to resolve the effect of seller’s escrow payment in this case, further underscoring the case-specific analysis that will be applied to these issues.

The Supreme Court’s reversal of the Court of Appeal’s judgment avoids the potentially devastating effects of the lower court’s ruling by finding that even where an illusory contract exists, that defect can be cured by partial performance of a bargained-for promise. The ruling, however,

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ultimately rests on the particular facts of *Steiner*. What constitutes valid consideration for real estate purchase and sale contracts when one party maintains the right to terminate the agreement in its sole and absolute discretion during an initial contingency period, such as an entitlement or due diligence period, remains unclear. Attorneys, developers and other real estate professionals should therefore continue to exercise great care when negotiating and drafting real estate purchase and sale agreements that include unilateral termination rights. Even in the wake of the Supreme Court's decision in *Steiner*, failure to exercise such care could cause the subject agreement to be recast as a "disguised" option, which in turn, could have an adverse impact on the enforceability of the agreement.

To discuss the ramifications of this recent case, please contact the undersigned.

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For additional information on this issue, contact:



[Matthew S. Urbach](#) Mr. Urbach is an experienced attorney whose practice focuses on a wide range of complex commercial litigation, with an emphasis on real estate and environmental matters. Mr. Urbach's experience includes litigation concerning purchase and development agreements, unlawful detainer, eminent domain, construction defects, landlord/tenant issues, and environmental contamination.



[Justin X. Thompson](#) Mr. Thompson's practice focuses on all aspects of real estate law. He handles a wide variety of real estate transactions, including transactions involving acquisitions, dispositions, land exchanges, sale-leasebacks, leasing and lending. He also advises and assists clients with issues pertaining to the negotiation, structure and documentation of commercial and industrial property ownership, development, management and financing.

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