
California Supreme Court Addresses the Enforceability of “Free Look” Purchase Contracts

On March 18, 2010, the California Supreme Court overturned the lower court's ruling in *Steiner v. Thexton* and found that the buyer's "partial performance" of actions contemplated by the contract, constituted the legal consideration needed to render that contract enforceable. The lower court had previously held that same contract - which gave the buyer unilateral, broad discretion to terminate - was not enforceable. The lower court had held that a buyer cannot enforce this kind of purchase agreement, and that the seller may walk away from such agreement even if the buyer has made significant progress in obtaining the entitlements contemplated by that agreement. The California Supreme Court disagreed. Once the buyer had performed "substantial efforts and expenditures" to pursue those entitlements, the contract, despite buyer's discretionary, unilateral right to terminate, was enforceable so long as the pursuit of those entitlements had been specifically "bargained-for" by the parties.

The facts of the *Steiner* case are not complicated. The buyer was willing to pay the purchase price and acquire the property contingent upon buyer's success in getting the local municipality to approve legally subdividing the parcel (ultimately via a tentative map application). The lower court thought the following language in the agreement was fatal: "It is expressly understood that the buyer may, at its absolute and sole discretion during [the pursuit of the subdivision approval], elect not to continue in this transaction and this purchase contract will become null and void." Although the buyer's contingency in *Steiner* went further than is customary, many real estate professionals refer to a contract with this kind of buyer-friendly contingency as "free look" contract. The lower court ruled that because the agreement allowed the buyer to do nothing, the agreement was an option agreement, and that the option was unenforceable due to lack of consideration.

In overturning the lower court, the California Supreme Court agreed the contract was lop-sided to the point of being a unilateral option agreement, but indicated that legal consideration for that option was present. Specifically, the court ruled that the following two facts, taken together, constituted legal consideration: (1) the buyer performed "substantial efforts and expenditures" to pursue entitlements, and (2) such efforts were "bargained-for" by the parties since the seller was induced to sign the contract by the prospect of the buyer pursuing the entitlements.

This case, at the trial court and both levels of appeal, is a strong reminder not to leave any doubt as to "legal consideration" in a contract. Neither the appeals court case nor the Supreme Court holding provided any absolute safe harbors as to free look contracts. Legal consideration can be in many cash and non-cash forms. Buyers, sellers and their attorneys need to give the legal consideration issue proper attention in all purchase and sale contracts.

For any questions regarding this topic, please contact our Real Estate Transactions practice group.