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Contracts as Commodities: Issues and Approaches in Regard to Commercial Real Estate Earnest Money and Option Contracts - A Texas Lawyer's Perspective.

Bille J. Ellis Jr.

Bennett I. Abramowitz

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CONTRACTS AS COMMODITIES: ISSUES AND APPROACHES IN REGARD TO COMMERCIAL REAL ESTATE "EARNEST MONEY" AND "OPTION" CONTRACTS—A TEXAS LAWYER'S PERSPECTIVE

BILLIE J. ELLIS, JR.*
BENNETT I. ABRAMOWITZ**

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* Shareholder, Kelly, Appleman, Hart & Hallman; B.A., University of Texas at Austin, 1974; M.B.A., Southern Methodist University, 1977; J.D., University of Houston, 1978.

** Attorney, Stutzman & Bromberg; B.A., Brooklyn College, 1970; M.A. and Ph.D., New York University, 1972, 1976; J.D., Southern Methodist University, 1981.

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I. INTRODUCTION

Real estate "earnest money" and "option" contracts[1] have evolved, in recent years, into highly speculative investment mediums, offering the buyer an opportunity for quick profit, while presenting him little, if any, financial risk. A purchaser, having obtained the right to purchase desirable property, may often make a substantial profit by selling his rights under the contract or, immediately upon closing his purchase, by selling the property under the contract. The use of these contracts not only reflects the speculator's desire to benefit from the employment of arbitrage in a market engendering rapidly escalating real estate values, but also reflects the heightened importance of due diligence reviews by purchasers and their attorneys, conducted to determine whether to purchase property. The use of the earnest money purchase contract is also partly attributable to recent profound

1. Many members of the business and legal real estate community commonly use the term "earnest money contract" to refer to any agreement whereby a party either has entered into a binding contract to purchase property and has deposited earnest money pursuant thereto, or a contract under which the purchaser has an option if it chooses to purchase the property. While the legal characteristics and distinctions of "earnest money" and "option" contracts will be examined in this article, both of these forms of contract, unless otherwise noted herein, will be referred to collectively as contracts.

changes occurring in the American economy and real estate development industry.[2]

The presently existing confluence of highly volatile interest rates, the frequent shortages of favorable traditional long term permanent financing, and the increase in the number and scope of municipal, state, and federal legal requirements and regulations affecting real estate development[3] make it difficult for even experienced and success-

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2. The following list of articles illustrates various changes which have occurred in the economy and real estate development industry, as well as indicating the interest and attention which these changes have engendered: Bernick, *Real Estate Write Off Change Approved by Finance Amidst Disagreements Within Industry,* 23 TAX NOTES 117 (1984); Blumenthal, *Effect of New Original Issue Discount Rules on Real Estate Syndications,* 14 TAX ADVISOR 594 (1983); Goldberg, *An Analysis of the New Temporary Rules on Reporting Foreign Investments in United States Realty,* 58 J. TAX'N 258 (1983); Joyce, *Governmental Issues Related to Real Estate Development,* 11 COLO. LAW. 2527 (1982); Kelly, *Fiduciary Duties Related to Pension Fund Investment in Real Estate,* 14 LOY. U. CHI. L.J. 253 (1983); Kuklin, *Impetus to an Industry—The Effect of Taxation of Real Estate and Real Estate Derived Income on Real Property Development in the United States,* 17 REAL PROP. PROB. & TR. J. 458 (1982); *1982 Legislation Affecting Real Property,* 18 REAL PROP. PROB. & TR. J. 244 (1983); Malloy, *The Interstate Land Sales Full Disclosure Act: Its Requirements, Consequences, and Implications For Persons Participating in Real Estate Development,* 24 B.C.L. REV. 1187 (1983); Peretz, *Rescission Under the Interstate Land Sales Full Disclosure Act,* 58 FLA. B.J. 297 (1984); Roberts, *Uniform Condominium Act—New Flexibility For Developers,* 40 J. MO. B. 177 (1984); Solomon, *The Section 1031 Exchange of Real Estate—Has ACRS Decreased Its Attractiveness?,* 10 J. REAL EST. TAX'N. 346 (1983); Tucker, *How TEFRA Affects Real Estate Investments: Analyzing Direct and Indirect Consequences,* 58 J. TAX'N 66 (1983); Comment, *Foreign Investment in United States Real Estate: Congress Acts to Reduce Incentives,* 7 INT'L. TRADE L.J. 150 (1981-1982).

3. One of the most time consuming and expensive aspects of preparing real property for development and ultimate sale in today's real estate market is the burden of adherence to the many local, state, and federal regulation and disclosure requirements. Compliance with these regulations is quite often necessary prior to the developer's first sale. For example, the development of a residential subdivision, condominium project, or office park could easily involve compliance with one or more federal or state laws. *See* Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601, 2602(1), 2603(a) (1983) (containing statement of purpose, definitions of federally related mortgages, and uniform settlement form and procedure for federally related mortgages); Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (1983) (declaring unfair methods of competition unlawful, defining penalties for violations, etc.); Truth in Lending Simplification and Reform Act, 15 U.S.C. §§ 1601-1665 (1983) (laws concerning disclosure, finance charges, annual percentage rates, enforcement, criminal liability, credit transaction requirements, credit advertising, etc.); Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691(F) (1983) (regarding credit discrimination, enforcement, application of state property laws, civil liability, etc.); Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720 (1983) (includes exemptions, requirements regarding sale or lease of lots, subdivision registration, certification of states requiring disclosure substantially equivalent to federal requirements, penalties, liability, etc.); Magnuson-Moss Warranty—Federal Trade Commission Act, 15 U.S.C. §§ 2301(1), 2302(a) (1983) (warranty requirements with regard to consumer products); Fair Housing Act of 1968, 42 U.S.C. §§ 3601-3631 (1983) (regarding discrimination in sale,

ful developers to irrevocably commit themselves to acquire property. The main reason for this difficulty is that such commitments could readily prove burdensome in the absence of satisfactory financing or the achieving of various approvals necessary to develop and market the targeted property.

To facilitate the developer's opportunity to tie up property with little or no money, whether it be to "flip" the property to an eager purchaser during a hot market, or for holding the property while the developer secures necessary financing or investigates whether the property can be developed economically and within prescribed time frames, attorneys in Texas and around the country have necesssarily shifted the legal import of the form of contract typically employed in real estate transactions. In previous times, when the real estate market was more stable and less subject to the volatility of the economy, the typical contract was an agreement that clearly bound the seller to sell the property and the purchaser to purchase the property. Today, however, the typical contract is an agreement whereby the seller is absolutely obligated to sell the property at a price certain on a specified date, but the purchaser's obligation to buy is less than absolute because it is subject to, or contingent upon, the fulfillment of various conditions. Conditions commonly found in this type of contract include the purchaser being satisfied as to the condition of title to the property, the availability of suitable financing, and suitable or desired zoning; these and other conditions frequently entail subjective judgment by the purchaser as to their satisfactory fulfillment. Furthermore, these contracts often provide that even should these conditions to closing be satisfactorily met, if the purchaser does not close the transaction, the seller is limited solely to the collection of earnest money as liquidated damages.[4]

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rental, financing of housing, enforcement, penalties, etc.); TEX. BUS. & COM. CODE ANN. §§ 17.41-17.61, 27.01 (Vernon 1968 & Supp. 1984) (Deceptive Trade Practices Act and Real Estate Fraud provisions).

4. The foregoing described purchaser-oriented contract provisions are generally not found in the current forms of contracts promulgated by the State Bar of Texas, or in the various local Board of Realtor forms commonly used by real estate brokers or attorneys who only occasionally prepare sales contracts. *See* LEGAL FORMS COMMITTEE OF THE STATE BAR OF TEXAS, LEGAL FORM MANUAL FOR REAL ESTATE TRANSACTIONS §§ 2.2A, 2.15-2.26 (1982); *Commercial Earnest Money Contract,* EL PASO BOARD OF REALTORS (n.d); *Commercial—Industrial Sales Contract,* GREATER FORT WORTH BOARD OF REALTORS, INC. (1983); *Commercial Property—Real Estate Sales Agreement,* SAN ANTONIO BOARD OF REALTORS, INC. (n.d); *Contract of Sale—Nonresidential,* GREATER DALLAS BOARD OF REALTORS, INC.

The real estate industry and the attorneys representing the industry have both accepted and adopted the nature and use of such purchaser-oriented contracts. Recent cases, however, illustrate that many attorneys in Texas have forgotten, or are unaware of, the necessary elements to create a binding and enforceable "earnest money" or "option" contract. These cases also serve to underscore the important differences arising from the distinctions drawn by Texas courts regarding the legal import of the character of the purchaser's and seller's obligations under either of these forms of contracts. Furthermore, it is clear that, while the real estate bar continues to create more sophisticated contracts to grant its developer and investor clients great latitude in deciding whether to go forward with a pending sale, a failure by a developer's attorney to recognize established Texas case law could result in his client losing the right to refuse to consummate a transaction that the client mistakenly believed he was under no obligation to close. Furthermore, as is indicated by a recent case, failure to fully understand the obligations created by particular types of contracts may result in a purchaser losing his right to require the consummation of the sale.[5]

The agreement to acquire real estate, whether it is an "earnest money" or "option" contract, is one of the most fundamental documents prepared and reviewed by the real estate practitioner. Recognizing the economic opportunity and the due diligence benefits of the purchaser-oriented contract, this article will analyze the elements necessary to create either an earnest money or option contract and will review the traditional and recent cases that distinguish the two forms of contracts. In addition, this article will place special emphasis on factual circumstances and contract language that the courts have re-

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(1981) (a copy of these contracts may be found at each of these offices). A review of these contracts reveals a bilateral agreement whereby seller and purchaser agree respectively to sell and purchase property. However, it has been the authors' observations that most attorneys who routinely represent developers employ, as a matter of course, contracts containing purchaser-oriented contract provisions. An examination of the various articles and materials from the more recent continuing legal education courses in Texas will provide excellent examples of typical approaches used by practitioners representing developers and speculators. *See* Heath, *Land Acquisition For an Income Producing Project,* STATE BAR OF TEXAS—ADVANCED REAL ESTATE LAW COURSE, at F-1 (1979); Schlanger, *Sale and Purchase of Income Producing Properties,* STATE BAR OF TEXAS—ADVANCED REAL ESTATE LAW COURSE, at P-1 (1980); Wallenstein, *Acquisitions and Dispositions of Income-Producing Properties,* STATE BAR OF TEXAS—ADVANCED REAL ESTATE LAW COURSE, at B-1 (1983).

5. *See* Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 854 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

lied on to distinguish these agreements. Finally, this article will offer drafting considerations and suggestions to help ensure that one's client can use the contract as a medium to acquire, flip, or develop the property with little or no money invested, while still retaining great discretion in deciding whether or not to consummate its purchase pursuant to the contract.

II. OPTION AND CONTRACT OF SALE DEFINED

The courts have adopted varying definitions or tests to determine the existence of an option. In general, the courts have declared that the distinction between an absolute contract of sale and an option is dependent upon the intention of the parties rather than the nomenclature they have employed.[6] This general principle is of limited use to the practitioner, but, fortunately, the courts have adopted various criteria by which the existence and nature of such intent may be determined.[7] An option to purchase real property is a unilateral contract

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6. *See, e.g.,* Broady v. Mitchell, 572 S.W.2d 36, 40 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.) (where contract language obligates seller to accept liquidated damages as sole remedy, agreement is option); Smith v. Hues, 540 S.W.2d 485, 488 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.) (mandatory obligation to receive liquidated damages shows intent to have option contract); Tabor v. Ragle, 526 S.W.2d 670, 676 (Tex. Civ. App.—Fort Worth 1975, writ ref'd n.r.e.). The court in *Ragle* stated that, in order for a contract to be considered an option, the contract must require that the vendor accept liquidated damages as his sole remedy. Although the provision in the contract allowing the vendor to seek specific performance had been deleted, the court allowed other evidence to show that the intent of the parties was not that the vendor's sole remedy would be liquidated damages. *See id.* at 676.

7. One line of cases has held that contracts which did not bind the second party to purchase were mere option contracts. *See, e.g.,* White v. Bank of Hanford, 83 P. 698, 698 (Cal. 1906) (contract stated: "White has an option of purchase . . . for the sum of $10,200 to be paid as follows, . . . $250 cash down, the balance . . . on or before August the 15th, 1903 and if said sum is not paid . . . then the above sum to be forfeited."); Black v. Maddox, 30 S.E. 723, 724 (Ga. 1898) ("in case the balance . . . is not paid . . . this agreement to be null and void and the money paid thereon to be considered as forfeited . . . as liquidated damages"); Swank v. Fretts, 59 A. 264, 264 (Pa. 1904) (language stated that "[a] failure of second party to make first payment within fifty days from above date shall render this agreement null and void"); Runck v. Dimmick, 111 S.W. 779, 780 (Tex. Civ. App. 1908, no writ) (language stated that " 'he will comply with the above conditions within thirty days or forfeit the earnest money' "). Other cases, however, have held that the mere fact that the contract does not formally bind a party to make payment is not conclusive of its character. *See, e.g.,* Griffith v. Bradford, 138 S.W. 1072, 1073 (Tex. Civ. App.—Fort Worth 1911, no writ) (contract did not expressly bind purchaser, yet court held obligation to be implied); Newton v. Dickson, 116 S.W. 143, 145 (Tex. Civ. App. 1909, no writ) (despite language stating that failure of either party to perform would result in forfeit of deposit, contract was not an option). An agreement to purchase has been implied from the fact that a person has subscribed his name to the con-

pursuant to which a right to purchase property at a certain price, on specified terms, and within a stated time is conferred on another by the owner.[8] In contrast, a contract for the sale of real property is an executory bilateral contract which binds the seller to sell and the buyer to buy specified property according to the terms of the contract, including the purchaser's unconditional obligation to pay the purchase price. The purpose of each of the parties to a contract of sale is to obligate the other party to perform and not merely to provide for one party to have an option between performance and nonperformance.[9] On the other hand, an option is an offer which is

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tract, or where the evidence expressly declares both parties' purpose is to enter into a contract. *See* Heath v. Huffhines, 152 S.W. 176, 177-78 (Tex. Civ. App.—Fort Worth 1912, no writ). An agreement which allows the purchaser to withdraw from the contract without suffering any loss beyond forfeiture of his deposit will most often be considered an option. *See* Slade & Bassett v. Crum, 193 S.W. 723, 724 (Tex. Civ. App.—Amarillo 1917, no writ) (contract which stated "[i]n default in payment of either of said amounts said Crudington is to forfeit to me the $2,000.00 heretofore paid" held to be option). Where the contract calls for forfeiture of the purchaser's deposit or initial payment because of noncompliance with the conditions of the sale, the contract is not rendered an option if the purpose for the forfeiture provision is to give the seller the option of accepting the deposit as damages, or the right to insist on the buyer's performance. *See* Hamburger & Dreyling v. Thomas, 118 S.W. 770, 773 (Tex. Civ. App. 1909), *aff'd,* 103 Tex. 280, 126 S.W. 561 (1910).

8. *See* Lefevere v. Sears, 629 S.W.2d 768, 770 (Tex. App.—El Paso 1981, no writ); White v. Miller, 518 S.W.2d 383, 385 (Tex. Civ. App.—Tyler, 1974, writ dism'd); State v. Clevenger, 384 S.W.2d 207, 210 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.). A relatively old case, Ide v. Leiser, 24 P. 695 (Mont. 1890), indicates that the principle underlying judicial construction of option contacts have remained basically the same for a long period of time. The court in *Ide* stated that:

> [A]n option, originally, is neither simply a contract by which the owner of property (real estate being the species we are now discussing) agrees with another person that he shall have the right to buy his property, at a fixed price, within a time certain. He does not sell his land; he does not then agree to sell it; but he does then sell something, viz., the right or privilege to buy at the election or option of the other party. The second party gets, *in praesenti,* not lands, or an agreement that he shall have lands, but he does get something of value; that is the right to call for and receive lands if he elects. The owner parts with his right to sell his lands, except to the second party, for a limited period. The second party receives this right, or rather, from his point of view, he receives the right to elect to buy.

Id. at 695.

9. *See, e.g.,* Thompson v. Wilkinson, 148 P. 177, 179 (Okla. 1915) (agreement of sale and purchase binds parties); Carroll v. Wied, 572 S.W.2d 93, 96 (Tex. Civ. App.—Corpus Christi 1978, no writ) (contract of sale obligates respective parties to buy and sell); Collier v. Robinson, 129 S.W. 389, 391 (Tex. Civ. App.—1910, writ ref'd) (contract binding parties to sell and purchase is contract of sale). Although an agreement may provide for forfeiture of purchase money partially paid if the remaining portion of the purchase price is not paid by a certain date, it is not an option where the parties expressly provide that the purchaser is obligated to purchase despite the forfeiture. *See* Heman v. Wade, 41 S.W. 740, 742 (Mo. 1897); Newton v.

irrevocable for a period of time during which the prospective purchaser may, but is not obligated to, accept the offer and become bound to purchase the property. The option thus constitutes a promise by the property owner to sell his land to the purchaser if, within the option period, the purchaser accepts the offer in the manner prescribed.[10]

In order for the option to be irrevocable for the period designated, the option must be supported by consideration independent of the purchase price itself.[11] In other words, the optionee must furnish con-

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Dickson, 116 S.W. 143, 144 (Tex. Civ. App.—1909, no writ). The *Newton* court held that the following language constituted a binding contract and not a mere option: "and to bind the above contract, we, the above contracting parties, deposit the sum of $1000 each with Dickson, Moore & Smith, the same to be forfeited by party failing to fulfill his part of above contract." *See id.* at 144; *see also* Heath v. Huffhines, 152 S.W. 176, 177 (Tex. Civ. App.—Fort Worth 1912, no writ). In *Heath,* the contract was held to be a contract of sale and not an option:

> and as earnest money, and as a part of the cash consideration above mentioned, the said A.N. Evans has this day paid to the said Heath $700 cash . . . should there be any defect in said title, that the said Heath shall have a reasonable time to cure said defect, and in case said title is not good the seven hundred dollars . . . shall be refunded to party of the second part, but should the said Heath furnish a good and sufficient warranty deed and abstract of title . . . and the said Evans fails or refuses to carry out his part of the contract, the said seven hundred dollars shall be forfeited . . . .

Id. at 177.

10. *See* Adams v. Peabody Coal Co., 82 N.E. 645, 646 (Ill. 1907) (optionor may not withdraw offer until time for acceptance has expired); Moore v. Kirgan, 250 S.W.2d 759, 763 (Tex. Civ. App.—El Paso 1952, no writ) ("lessor cannot withdraw his offer before the time for its acceptance has expired. . . ."; optionee has protectable inchoate right)(quoting 35 C.J. *Landlord and Tenant* § 182 (1924)); *cf.* Colligan v. Smith, 366 S.W.2d 816, 820 (Tex. Civ. App.—Fort Worth 1963, writ ref'd n.r.e.) (optionor may not act so as to cause delay by optionee in exercising his rights).

11. *See, e.g.,* Plantation Key Dev. v. Colonial Mortgage Co., 589 F.2d 164, 168 (5th Cir. 1979) (underlying contract and option require independent consideration); Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 853 (Tex. App.—Dallas 1983, writ ref'd n.r.e.) (both components of contract must be supported by consideration); Echols v. Bloom, 485 S.W.2d 798, 800 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.) (if no consideration passes, option revocable); *see also* Granger Real Estate Exch. v. Anderson, 145 S.W. 262, 264 (Tex. Civ. App.—Austin 1912, no writ) (option itself is contract; if not supported by consideration may be withdrawn); 1A A. CORBIN, CORBIN ON CONTRACTS § 263, at 499 (1963 & Kaufman Supp. 1980) (option contract may be "made by a promise for which a consideration is given"). *But see* TEX. BUS. & COM. CODE ANN. § 2.205 (Tex. UCC) (Vernon 1968) (provides that firm offers remain irrevocable for up to three months without consideration in case of sales of goods by merchant). The consideration necessary to make an option irrevocable need not be large in order to be considered sufficient. If, however, the consideration is both nominal in fact and in amount, as where it is merely recited and not actually given or promised, the optionor may revoke his offer. *See* Echols v. Bloom, 485 S.W.2d 798, 800 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.); 1A A. CORBIN, CORBIN ON CONTRACTS § 263, at 501 (1963 & Kaufman Supp. 1980).

sideration for the extension of the option, or the owner can revoke his offer at any time prior to the optionee's acceptance.

If the terms of the option allow the purchaser's acceptance to be by notice (as opposed to payment of the purchase price), once the option is accepted, it then becomes a bilateral contract of sale which is binding on both parties. A binding contract is said to exist, whether or not the option was originally supported by consideration, because the offer and acceptance are mutual promises (one by the seller to sell and one by the purchaser to buy) which constitute consideration for an executory bilateral contract of sale.[12] If, however, the option specifies that acceptance is accomplished only by the purchaser's payment of the purchase price, the contract of sale stage is bypassed, and the sale is consummated upon acceptance of the option, the parties never having exchanged mutual promises to buy and sell. In such case, absent independent consideration, the seller may revoke the option prior to the payment of the purchase price.[13]

An earnest money contract is simply a contract of sale which requires the purchaser to pay to either the seller or an escrow agent a sum of money as earnest money prior to the closing, at which time the balance of the purchase price is rendered.[14] The earnest money is intended to secure the performance of the purchaser, but it is not necessary to make the contract binding unless the provision for earnest money is so material as to constitute a condition precedent to the for-

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12. *See* Texas Gas Utils. Co. v. Barrett, 460 S.W.2d 409, 412 (Tex. 1970) (quoting Texas Farm Bureau Cotton Ass'n v. Storal, 113 Tex. 273, 285, 253 S.W. 1101, 1105 (1923)). In *Barrett,* the court stated:

> Reduced to its last analysis, the rule is simply that a contract must be based upon a valid consideration, and that a contract in which there is no consideration moving from one party, or no obligation upon him, lacks mutuality, is unilateral, and unenforceable. . . . It is quite elementary that the promise of one party is a valid consideration for the promise of the other party.

Id. at 412; *see also* Clement v. Producer's Ref. Co., 277 S.W. 634, 635 (Tex. Comm'n App. 1925, judgmt adopted) ("Where no other consideration is shown, mutual obligations by the parties . . . will furnish a sufficient consideration to constitute a binding contract."); Saunders v. Commercial Indus. Serv., 541 S.W.2d 658, 659 (Tex. Civ. App.—Eastland 1976, writ ref'd n.r.e.) (quoting principles set out in *Clement);* Smith v. Hues, 540 S.W.2d 485, 490 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.) ("Yet if the option is properly accepted the optionor is bound thereby and the optionee may obtain specific performance.").

13. *See* Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 854 (Tex. App.—Dallas 1983, writ ref'd n.r.e.) (gratuitous option may be revoked prior to acceptance).

14. *See* Cowman v. Allen Monuments, Inc., 500 S.W.2d 223, 225-26 (Tex. Civ. App—Texarkana 1973, no writ); State v. Clevenger, 384 S.W.2d 207, 210 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.).

mation of a binding contract.[15] In *Cowman v. Allen Monuments, Inc.*,[16] the court noted that there is a difference between the consideration for the sale (the sales price of the land) and the consideration for the contract. It is not necessary that any money be paid at the time a contract of sale is executed in order for it to be binding and supported by consideration, as the mutual promises to buy and sell constitute sufficient consideration to make the contract binding.[17]

III. Option and Contract of Sale Distinguished—The Test Used by Texas Courts

As a result of many Texas decisions, a test has evolved distinguishing options and earnest money contracts of sale. Basically, when an agreement for the purchase and sale of land provides that the seller's *sole* remedy in the event of the purchaser's default is retention of the earnest money as liquidated damages, the agreement is an option contract rather than a bilateral contract of sale.[18] The rationale underlying this rule is that if an agreement provides that the purchaser can decline to close the transaction by forfeiting his earnest money as liquidated damages and also be exculpated from further liability, the effect of the instrument is to create an option. Thus, when the seller

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15. *See* Cowman v. Allen Monuments, Inc., 500 S.W.2d 223, 228 (Tex. Civ. App.—Texarkana 1973, no writ). "It is only when the provision for a down payment or an earnest money deposit is so material to the complete agreement that it constitutes a condition precedent, that the failure to comply therewith will prevent the agreement from ever becoming a binding contract." *Id.* at 228.

16. *Id.* at 223.

17. *See id.* at 227; *see also* Ragan v. Schreffler, 306 S.W.2d 494, 499 (Mo. 1957). The court stated:

> It is the recognized general rule that a promise by one party to a contract is a sufficient consideration for a promise by the other party. If, therefore, there is a promise on the part of a purchaser to buy and pay the purchase price, this itself is a sufficient consideration for the promise of a vendor to sell and convey.

Id. at 499. This statement by the Missouri Supreme Court was cited with approval by the Texarkana court of appeals. *See* Cowman v. Allen Monuments, Inc., 500 S.W.2d 223, 227 (Tex. Civ. App.—Texarkana 1973, no writ).

18. *See* Paramount Fire Ins. Co. v. Aetna Casualty & Surety Co., 353 S.W.2d 841, 843 (Tex. 1962); Moss & Raley v. Wren, 102 Tex. 567, 569-70, 120 S.W. 847, 847 (1909); Texlouana Producing & Ref. Co. v. Wall, 257 S.W. 875, 878 (Tex. Comm'n App. 1924, judgmt adopted); Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 853-54 (Tex. App.—Dallas 1983, writ ref'd n.r.e.); John Dull & Co. v. Life of Neb. Ins. Co., 642 S.W.2d 1, 2 (Tex. Civ. App.—Houston [1st Dist.] 1981, no writ); Broady v. Mitchell, 572 S.W.2d 36, 40 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.); Reiser v. Jennings, 143 S.W.2d 99, 104 (Tex. Civ. App.—Amarillo 1940, writ dism'd judgmt cor.); Tate v. Morris, Graham & Morris, 248 S.W. 797, 800 (Tex. Civ. App.—Fort Worth 1922, no writ).

does not have the right to specific performance, but is confined to the remedy of liquidated damages, the arrangement is deemed to be an option rather than an absolute agreement of sale and purchase.[19]

State v. Clevenger[20] represents the one aberration from the line of cases noted above. The Houston court of appeals, in *Clevenger,* expressly held that a contract which limited the seller's sole remedy against a defaulting buyer to liquidated damages constituted a contract of sale and not an option.[21] The case is weak authority on this point since it ignores the long line of cases indicating that such a contract is in fact an option.[22] Additionally, though the case received a "writ refused, no reversible error" designation from the Texas Supreme Court, it was a condemnation case in which the importance of the nature of the instrument was evidentiary, and the appeals court itself stated that admitting the instrument as a contract of sale was harmless error.[23]

In determining whether an agreement is an option contract or a contract of sale, it is important to remember that, as a matter of law, the seller has the right to seek specific performance of a contract by

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19. The following contractual provision exemplifies the type of language which will typically render an agreement between parties an option rather than a contract of sale:

> And it is further mutually agreed, in case purchaser fails to comply with the terms hereof relating to the payment and securing of the purchase price as above mentioned, and by the time herein designated, purchaser shall forfeit the amount paid hereon to seller, and the same shall be paid to seller by said trustees and accepted by said seller as and for liquidated damages for such injury and damage as the seller may suffer by reason of the nonperformance of this contract on the part of the purchaser.

Moss & Raley v. Wren, 102 Tex. 567, 569-70, 113 S.W. 739, 739 (1908). In deciding that this language constituted an option rather than a contract of sale, the Texas Supreme Court addressed the issues presented in the following manner:

> [B]ut, if the seller is bound to accept the sum for such damages as may be suffered by reason of the nonperformance of the contract on part of the purchaser, can he sue the proposed purchaser for specific performance of the contract? . . . [S]hould [purchaser] decline for any reason to pay the price and to accept the land, he may pay the liquidated damages and be absolved from further suit . . . . For this reason we answer the question in the negative.

Id. at 569-70, 120 S.W. at 847.

20. 384 S.W.2d 207 (Tex. Civ. App.—Houston 1954, writ ref'd n.r.e.).

21. *See id.* at 210.

22. *See id.* at 210. The court based its decision on the fact that: "[t]he signatories to such contract in the utmost good faith entered into a valid and binding agreement for the sale and purchase of the land in question . . . ." The court also placed emphasis on the fact that the parties mutually obligated themselves to buy and sell according to their agreement and that nothing other than the final performance remained to be done. *See id.* at 210.

23. *See id.* at 211.

the purchaser[24] unless the contract expressly provides that liquidated damages are to be the seller's sole and exclusive remedy.[25] Therefore, unless the contract provides that the seller must accept liquidated damages in full settlement of the buyer's liabilities for failure to purchase the property, without any other recourse against the buyer, the contract is not an option.[26] Thus, the mere fact that the contract entitles the seller to receive liquidated damages upon the buyer's default does not render it an option since the seller could also still be entitled to specific performance.[27]

An extreme example of the courts' tendency to construe contracts so as to allow any remedy not specifically excluded is *Bifano v. Young.*[28] In *Bifano,* the parties signed a printed lease form, in which they deleted two of three remedies listed under the heading "Remedies of Landlord" and also deleted the final paragraph declaring the

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24. *See, e.g.,* Hage v. Westgate Square Commercial, 598 S.W.2d 709, 712-13 (Tex. Civ. App.—Waco 1980, writ ref'd n.r.e.) (vendor may have suit for specific performance and part of relief may include foreclosure of implied vendor's lien); Tabor v. Ragle, 526 S.W.2d 670, 675 (Tex. Civ. App.—Fort Worth 1975, writ ref'd n.r.e.) (general rule is that vendor or vendee may sue for specific performance); Clifton v. Charles, 116 S.W. 120, 122 (Tex. Civ. App.—1909, writ ref'd) (upon nonperformance vendee or vendor may enforce specific performance against breaching party). *But see* Rosenfield v. Pollock Realty Co., 416 S.W.2d 833, 836-37 (Tex. Civ. App.—Dallas 1967, no writ) (where vendor could not deliver clear title, specific performance not available); Alling v. Vander Stucken, 194 S.W. 443, 444 (Tex. Civ. App.—San Antonio 1917, writ ref'd) (where vendor in default, purchaser not compelled to perform).

25. *See* Tabor v. Ragle, 526 S.W.2d 670, 675 (Tex. Civ. App.—Fort Worth 1975, writ ref'd n.r.e.).

26. *See* Gala Homes, Inc. v. Fritz, 393 S.W.2d 409, 411 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.). In *Gala,* the court held that in determining whether a contract is an option or a contract of sale,

> the test for determining the effect of the provisions relating to the down payment as liquidated damages is whether the seller is "*bound*" to accept the sum "for such damages as may be suffered by reason of the nonperformance of the contract" on the purchaser's part, . . . otherwise he can enforce the contract by requiring specific performance.

Id. at 411; *see also* Paramount Fire Ins. Co. v. Aetna & Surety Co., 353 S.W.2d 841, 843 (Tex. 1962) (forfeiture provision will not change status of contract of sale unless stated to be vendor's sole remedy); Tabor v. Ragle, 526 S.W.2d 670, 675 (Tex. Civ. App.—Fort Worth 1975, writ ref'd n.r.e.) (citing proposition set forth in *Gala).*

27. *See* Paramount Fire Ins. Co. v. Aetna & Surety Co., 353 S.W.2d 841, 843 (Tex. 1962); *see also* Texlouana Producing & Ref. Co. v. Wall, 257 S.W. 875, 878 (Tex. Comm'n App. 1924, judgmt adopted). The contract in *Texlouana* did contain a forfeiture provision, but the court held that, as it was merely intended to secure performance and did not require that the vendor accept the liquidated damages as his sole remedy, the vendor was not precluded from seeking specific performance. *See id.* at 878.

28. 665 S.W.2d 536 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e).

list to be nonexclusive. The lease provisions interpreted by the court set forth the landlord's remedies as follows:

> 20. REMEDIES OF LANDLORD: Upon the occurrence of any of the events of default listed in Section 19, Landlord shall have the option to pursue any one or more of the following remedies without any notice or demand whatsoever.
>
> A. Terminate this lease, in which event Tenant shall immediately surrender the demised premises to Landlord. If Tenant fails to so surrender such premises, Landlord may, without prejudice to any other remedy which it may have for possession of the demised premises or arrearages in rent, enter upon and take possession of the demised premises and expel or remove Tenant and any other person who may be occupying such premises or any part thereof, by force if necessary, without being liable for prosecution or any claim for damages therefor. Tenant shall pay to Landlord on demand the amount of all loss and damage which Landlord may suffer by reason of such termination, whether through inability to relet the demised premises on satisfactory terms or otherwise.
>
> ~~B. Enter upon and take possession of the demised premises, by force if necessary, without terminating this lease and without being liable for prosecution or for any claim for damages therefor, and expel or remove Tenant and any other person who may be occupying such premises or any part thereof. Landlord may relet the demised premises and receive the rent therefor. Tenant agrees to pay to Landlord monthly or on demand from time to time any deficiency that may arise by reason of any such reletting. In determining the amount of such deficiency, the brokerage commission, attorneys' fees, remodeling expenses and other costs of reletting shall be subtracted from the amount of rent received under such reletting.~~
>
> ~~C. Enter upon the demised premises, by force, if necessary, without terminating this lease and without being liable for prosecution or for any claim for damages therefor, and do whatever Tenant is obligated to do under the terms of this lease. Tenant agrees to pay Landlord on demand for expenses which Landlord may incur in thus effecting compliance with Tenant's obligations under this Lease, together with interest thereon at the rate of 10% per annum from the date expended until paid. Landlord shall not be liable for any damages resulting to the Tenant from such action, whether caused by negligence of Landlord or otherwise.~~
>
> ~~Pursuit of any of the foregoing remedies shall not preclude pursuit of any of the other remedies herein provided or any other remedies provided by law, nor shall pursuit of any remedy herein provided constitute a forfeiture or waiver of any rent due to Landlord hereunder or of any~~

~~damages accruing to Landlord by reason of the violation of any of the terms, conditions and covenants herein contained.~~[29]

Even though paragraphs (B) and (C) and the succeeding non-exclusive remedies paragraph of the form were marked through and the deletion was initialed by both parties, because the first sentence of that portion of the lease said that the landlord could pursue the listed remedies at his "option," the deletion of the provision declaring the listed remedies to be a non-exclusive provision was held to be insufficient to evidence the parties' intent to limit the landlord's remedies to the one remedy listed.[30] While this case concerns the interpretation of a lease, there are many printed contracts of sale containing similar provisions, and attorneys frequently cross out alternative remedy clauses with the intention that the remaining clause shall be the only applicable remedy upon default.

Another recent example of the tendency of the courts to permit any remedy which is not explicitly barred by specific contractual limitations of remedies is found in *Ryan Mortgage Investors v. Fleming-Wood.*[31] In this case, the contract in question specifically authorized only one remedy, but did not expressly bar the pursuit of any other remedy and, therefore, did not preclude the plaintiff from pursuing any other remedy which the law afforded in addition to the remedy specifically provided in the contract. The specific provisions of this contract stated:

> 12. SELLER warrants and represents to BUYER that at the time of closing hereunder it will have and will convey to BUYER good and mar-

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29. *Id.* at 543-44 (lease as marked through by the parties reprinted following opinion).

30. *See* Bifano v. Young, 665 S.W.2d 536, 539 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.). The appellant in *Bifano* contended that, by striking through the form provisions for remedies on default, the parties intended that appellee's only available remedy was to be that listed in paragraph (A), relating to termination of the lease and any damages resulting therefrom. The court rejected this contention by stating that the lease provision stipulating that appellee had "the option to pursue any one or more of the following remedies without any notice or demand whatsoever" was not marked through by the parties. *See id.* at 539. The court also noted that remedies provided in a contract may be permissive or exclusive. In order for the remedy to be considered exclusive it must be shown that the parties *clearly* indicated that their intent was that it be exclusive. *See id.* at 539; *see also* Vandergriff Chevrolet Co. v. Forum Bank, 613 S.W.2d 68, 70 (Tex. Civ. App.—Fort Worth 1981, no writ) (remedies may be exclusive or permissive; must have clear intent to be exclusive); West Texas Utils. Co. v. Huber, 292 S.W.2d 702, 703 (Tex. Civ. App.—Eastland 1956, writ ref'd n.r.e.) (if remedy is permissive, it is in addition to those provided by law).

31. 650 S.W.2d 928 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.).

ketable title to the Property, free and clear of any and all encumbrances, except those set forth in Exhibit "B.". . .

17. In the event the Seller is unable to convey title to the Property in accordance with Paragraph 12 of this Contract, BUYER may at its option terminate this Contract by written notice delivered to SELLER on or prior to the scheduled closing date (as deferred by any postponement in accordance with Paragraph 19); otherwise BUYER shall be conclusively deemed to have accepted SELLER'S title.[32]

Upon discovery that his client did not have marketable title, the seller's attorney advised the purchaser that he had two alternatives under the contract: either to accept title with the lis pendens in place (the element rendering the title unmarketable) or to terminate the contract. The surprised seller, to his chagrin, discovered that, despite the language providing that the purchaser could either receive a refund of its earnest money or elect to close notwithstanding title defects, the purchaser could also seek damages for the seller's failure to convey marketable title to the property.[33] Thus, the importance of expressly limiting the remedies allowed for breach of contract by explicitly reciting that they are the sole and exclusive remedies and are to be accepted in full satisfaction of the breaching party's liabilities can readily be seen. Failure to carefully articulate such limitations will transform what a purchaser intended to be an "option" contract into a contract of sale.

IV. DIFFERENCES IN OPERATION AND EFFECT

It is important to be aware of whether an agreement will be deemed a contract of sale or an option due to the legal differences in construction and consequences. This is true regardless of whether one's client is a seller or purchaser.

A. *Time of the Essence*

Unless otherwise stated, time is not of the essence in a contract of

32. *Id.* at 933.

33. *See id.* at 933. The sellers argued that the remedies under paragraph 17 were exclusive and thereby excused the lack of marketable title on the closing date. The court stated that, despite the express remedies provision in paragraph 17, the seller was still under a duty to convey marketable title. Although paragraph 17 gave the buyer a remedy which he did not have under common law, it did not expressly exclude his common law remedies, and, therefore, the buyer was not precluded from asserting such remedies, as well as those specifically provided. *See id.* at 933.

sale, whereas it is in an option contract.[34]

B. *Substantial Compliance*

Similarly, substantial compliance may be sufficient with regard to the time of performance in a contract of sale,[35] but strict compliance with the terms of the option contract is required in the optionee's exercise of an option.[36] Since an option contract is strictly construed so as to limit the obligation of the optionor, even minor deviation from its prescribed terms can extinguish the rights of the optionee. Thus, if a purchaser arrived for a closing a few hours late with closing papers which deviated from the contractual specifications in some minor way, the contract for sale would probably still be binding, although the breaching party would be liable for any damages caused by the breach. However, if an optionee exercised the option one minute late, or by telephone when telegram was required, the option would be terminated because no valid exercise of the option in the prescribed mode had occurred.[37] The optionee is not, however, liable

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34. It has long been accepted that time is of the essence in an option contract. *See* Johnson v. Portwood, 89 Tex. 235, 245, 34 S.W. 596, 598 (1896); Smith v. Hues, 540 S.W.2d 485, 488 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.); White v. Miller, 518 S.W.2d 383, 386 (Tex. Civ. App.—Tyler 1974, writ dism'd); Herber v. Sanders, 336 S.W.2d 783, 785 (Tex. Civ. App.—Amarillo 1960, no writ); McCaleb v. Wyatt, 257 S.W.2d 880, 881 (Tex. Civ. App.—Fort Worth 1953, writ ref'd n.r.e.). In an ordinary contract of sale, time is not of the essence unless the contract explicitly provides such. *See* Smith v. Warth, 483 S.W.2d 834, 836 (Tex. Civ. App.—Waco 1972, no writ); Gala Homes, Inc. v. Fritz, 393 S.W.2d 409, 411-12 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.). Thus, one of the essential differences between an option and a conditional sale is that where an option does not provide a time limit within which the optionee must act, the law will presume that a reasonable time was intended; where a conditional sales contract provides no time limit, a reasonable time will not be presumed by law. *See* Lusher v. First Nat'l Bank, 260 S.W.2d 621, 626 (Tex. Civ. App.—Fort Worth 1953, writ ref'd n.r.e.).

35. *See, e.g.,* Carroll v. Wied, 572 S.W.2d 93, 96 (Tex. Civ. App.—Corpus Christi 1978, no writ); Herber v. Sanders, 336 S.W.2d 783, 784 (Tex. Civ. App.—Amarillo 1960, no writ); Shields v. Dunlap, 174 S.W.2d 642, 645 (Tex. Civ. App.—Eastland 1943, no writ).

36. *See* Zeidman v. Davis, 161 Tex. 496, 499, 342 S.W.2d 555, 558 (1961) ("in the absence of equities an optionee is held to a strict compliance with the terms of the option agreement"); Suiter v. Woodard, 635 S.W.2d 639, 641 (Tex. App.—Waco 1982, writ ref'd n.r.e.) ("must be accepted strictly in accordance with its terms"); White v. Miller, 518 S.W.2d 383, 385 (Tex. Civ. App.—Tyler 1974, writ dism'd). In *White,* the court stated:

> To be effectual, acceptance of an option must be unqualified, absolute, unconditional, unequivocal, unambiguous, positive, without reservation and according to terms or conditions of the option. Substantial compliance with the terms of an option is not sufficient to constitute an acceptance. The acceptance must be in identical terms with the offer.

Id. at 385.

37. *See* Sanchez v. Dickinson, 551 S.W.2d 481, 485 (Tex. Civ. App.—San Antonio 1977,

in any way with respect to such nonconformity because he never had incurred any obligation to perform in the first place; an option merely confers the right, but not the obligation, to purchase property upon the optionee, provided such right is exercised in accord with the terms of the option.[38]

C. *Risk of Loss*

Another important difference between an option and a contract of sale pertains to who bears the risk of loss. In the case of a contract of sale and in the absence of any provisions addressing the issue of risk of loss, the equitable title passes to the purchaser and with it the risk of loss, under the doctrine of equitable conversion.[39] As an option does not confer on the optionee an equitable or legal interest in the land subject to the option,[40] the risk of loss remains with the seller until the option is exercised and becomes a binding contract of sale;[41] should loss occur, however, the optionor is not required to restore the property, and the optionee is not entitled to an abatement of the purchase price.

D. *Broker's Right to Commission*

Whether a broker is entitled to his commission is frequently dependent on whether he procured a buyer who entered into a contract of sale or who is merely a party to an option. Generally, to be entitled to a commission, the broker must procure a purchaser who is ready, willing, and able to buy on terms acceptable to the seller and secure

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no writ) (must act in accordance with terms as set out in contract); Lambert v. Taylor Tel. Coop., Inc., 276 S.W.2d 929, 932 (Tex. Civ. App.—Eastland 1955, no writ) (must have strict compliance; acceptance modifying terms no acceptance).

38. *See* Sinclair Ref. Co. v. Allbritton, 147 Tex. 468, 475, 218 S.W.2d 185, 188 (1949); Northside Lumber & Bldg. Co. v. Neal, 23 S.W.2d 858, 859 (Tex. Civ. App.—Fort Worth 1929, no writ).

39. *See* Paramount Fire Ins. Co. v. Aetna Casualty & Surety Co., 353 S.W.2d 841, 844-45 (Tex. 1962); Lay v. Aetna Ins. Co., 599 S.W.2d 684, 686 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.); Smith v. Warth, 483 S.W.2d 834, 836 (Tex. Civ. App.—Waco 1972, no writ). "[W]here property contracted to be sold is damaged by fire, storm or other cause, not the fault of either party to the contract, the loss will fall on the party who, at the time, owned the beneficial interest in the property." *Id.* at 836.

40. *See* Whitson Co. v. Bluff Creek Oil Co., 278 S.W.2d 339, 342 (Tex. Civ. App.—Fort Worth 1955) (option is executory contract which passes no title), *aff'd,* 156 Tex. 139, 293 S.W.2d 488 (1956).

41. *Cf.* 5A J. APPLEMAN & J. APPLEMAN, INSURANCE LAW AND PRACTICE § 3366, at 219 (1970) (option holder has no equitable title and not entitled to insurance proceeds).

from the purchaser an enforceable contract in writing.[42] Thus, where there are no provisions denying the broker his commission upon the default of the purchaser, the broker is entitled to his commission regardless of whether or not the buyer defaults under the contract of sale.[43] If the purchaser declined to close under an option, however, the broker would not be so entitled.[44]

E. *Evidentiary Value in Condemnation Cases*

The evidentiary value of an option and a contract of sale in a condemnation case also differs. An option contract is not admissible as evidence to show land value;[45] a contract of sale, on the other hand, is competent evidence of land value in a condemnation suit.[46] If the contract was not consummated, the evidentiary weight of the contract might be affected, but the contract is nevertheless admissible.[47]

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42. *See* Fuess v. Mueller, 630 S.W.2d 715, 717 (Tex. App.—Houston [1st Dist.] 1982, no writ); Neigut v. McFadden, 257 S.W.2d 864, 868 (Tex. Civ. App.—El Paso 1953, writ ref'd n.r.e.); Cohen v. Cottle, 193 S.W.2d 430, 431 (Tex. Civ. App.— El Paso 1945, no writ). The terms "ready," "willing," and "able" each convey a distinct idea, and all three elements must be present in order for the broker to be entitled to his commission. It has been held that a purchaser is not willing to deal when before the transaction becomes binding, he refuses to consummate it, or asks for additional time to consider particular aspects of the transaction. *See* Sheehan v. Driskell, 465 S.W.2d 402, 404 (Tex. Civ. App.—Houston [14th Dist.] 1971, writ ref'd n.r.e.) (broker not entitled to commission where purchaser withdrew offer before acceptance by seller); Granger Real Estate Exch. v. Anderson, 145 S.W.2d 262, 263 (Tex. Civ. App.—Austin 1912, no writ) (broker not entitled where prospective purchaser requested extra time to perform).

43. *See* Hamburger & Dreyling v. Thomas, 103 Tex. 280, 283, 126 S.W. 561, 561 (1910); Wilson v. Crawford, 130 S.W. 227, 230 (Tex. Civ. App.—1910, no writ).

44. *See* Phillips v. Jones, 283 S.W. 298, 299 (Tex. Civ. App.—El Paso 1926, no writ); Runck v. Dimmick, 111 S.W. 779, 780 (Tex. Civ. App.—1908, no writ).

45. *See* Hanks v. Gulf, Colo. & S.F. Ry., 159 Tex. 311, 316, 320 S.W.2d 333, 336 (1959) (unaccepted offer not admissible evidence); State v. Clevenger, 384 S.W.2d 207, 209 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.) ("unaccepted offers to buy or sell are incompetent evidence of land value in condemnation suits"); Loumparoff v. Housing Auth., 261 S.W.2d 224, 228 (Tex. Civ. App.—Dallas 1953, no writ) (unaccepted offer constitutes inadmissible evidence).

46. *See* State v. Clevenger, 384 S.W.2d 207, 210 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.).

47. *See id.* at 209; *see also* Robards v. State, 285 S.W.2d 247, 249 (Tex. Civ. App.—Austin 1955, writ ref'd n.r.e.). In *Robards,* the court admitted the amount of the contract as competent evidence in an eminent domain proceeding and stated: "A contract of sale is not an offer. It is, if valid, a binding obligation on all parties. In our opinion it was admissible. That the contract was rescinded could of course be shown as lessening its weight as evidence of market value." *See id.* at 249.

F. *Consideration*

Because the form of earnest money contract frequently used by purchasers is actually an option, albeit the purchaser is frequently not aware of its status as such, problems can arise if the question of consideration for the option is not addressed by the contract's draftsman. As noted earlier, an option must be supported by consideration necessary to make the option irrevocable, since no promise to buy the land can serve as consideration for the option.[48] A promise to pay earnest money may constitute consideration for an option, so long as the optionee is actually obligated to pay the money, or a portion thereof, even if the purchaser terminates the contract during his "free look" contingency period.[49]

Echols v. Bloom[50] and *Hott v. Pearcy/Christon, Inc.*,[51] illustrate the problem confronting the purchaser when an earnest money contract is discovered to be an option and the earnest money has not been paid. In *Echols,* a proposed earnest money contract of sale, that provided an option period for accepting the contract, recited that $500 earnest money had been paid. The earnest money was not actually tendered until the last day of the option period. Prior to the time the consideration passed, and prior to the buyer's acceptance, the seller revoked the offer. Because the option was not supported by consideration and had not been accepted, the seller was free to revoke his offer, and the buyer had no recourse against the seller with respect to the seller's

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48. *See supra* notes 11, 12; *see also* 1A A. CORBIN, CORBIN ON CONTRACTS § 263, at 505 (1963 & Kaufman Supp. 1983), which states:

> Where a promise or agreement that is in form contractual is in fact not binding for lack of . . . consideration . . . it is a mere revocable offer, not an option contract. The offeree has a power of acceptance and has an option between accepting and not accepting. . . . So, if the only consideration is an illusory promise, there is no contract and no binding option . . . .

Id. at 505.

49. *See* 1A A. CORBIN, CORBIN ON CONTRACTS § 263 (1963 & Kaufman Supp. 1983); *see also* 14 TEX. JUR. 3d *Contracts* § 138, at 229-30 (1981), which states:

> A contract by which one person promises to sell or convey to another an interest in land, in consideration of money to be paid or acts to be performed by the other party, is lacking in mutuality and cannot be enforced if the agreement does not, at the same time, absolutely bind the other party to pay or perform the consideration stipulated.

Id. at 229-30.

50. 485 S.W.2d 798 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.).

51. 663 S.W.2d 851 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

revocation.[52] The *Echols* court noted that if a contract which is supported by sufficient consideration contains an option, no independent consideration for the option need appear.[53]

A most common example of an enforceable option lacking independent consideration is a lease contract which contains a purchase option. The purchase option, as well as the use of the premises, is supported (i.e., deemed to be granted in partial consideration of) by the tenant's agreement to pay rent.[54] This analysis would not, in most instances, apply to a contract of sale which contains an option period for acceptance because no binding contract of sale arises until the option is exercised, and the customary consideration for the contract is the promise to buy. Therefore, in order to insure that the seller cannot back out, the optionee must tender independent consideration for the option at its inception, rather than at the time of its exercise.[55]

In *Hott,* an earnest money contract was held to be an option because the buyer's liability under the contract was limited to the forfeiture of his earnest money.[56] The instrument did not require an

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52. *See* Echols v. Bloom, 485 S.W.2d 798, 800-01 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.).

53. *See id.* at 800.

54. *See* Moore v. Kirgan, 250 S.W.2d 759, 762-63 (Tex. Civ. App.—El Paso 1952, no writ). The *Moore* court clearly set forth the law regarding purchase options:

> An option to purchase, being an integral part of a lease, is a substantial part of the whole contract, and is not obnoxious to the objection that there is a want of mutuality, and the agreement to pay rent or do other acts will support the option as well as the right to occupy under the lease, and bind the lessor notwithstanding the lessee is not bound to purchase. The lessor cannot withdraw his offer before the time for its acceptance has expired, without the lessee's consent, although the contract is not under seal, or after the lessee exercises the option according to the terms of the agreement. The option constitutes a completed purchase of a right to have a conveyance if the purchaser shall choose to buy on the terms named. And while no right or estate in the land passes under a covenant for an option to purchase, it is an inchoate right which will be protected in equity pending the option period. The option to purchase is a covenant running with the land.

Id. at 762-63 (quoting 35 C.J. *Landlord & Tenant* § 182 (1924)). Where the option and the lease constitute one contract, the provisions of which are independent, the agreement to pay rent will be sufficient consideration to support the option. *See id.* at 763; *see also* Hereford v. Tilson, 198 S.W.2d 275, 279 (Tex. Civ. App.—Amarillo 1946) (agreement to pay rent sufficient consideration for option), *rev'd on other grounds,* 145 Tex. 600, 200 S.W.2d 985 (1947).

55. *See* Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 853 (Tex. App.—Dallas 1983, writ ref'd n.r.e.); Echols v. Bloom, 485 S.W.2d 798, 800 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.)

56. *See* Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 853 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

immediate payment of earnest money, but provided that the buyer would make a series of payments to extend the deadline of the financing contingency period provided in the contract. The seller revoked the option before the first payment was made. Since during the contract's initial period of time no consideration had passed and the option had not been exercised, the seller was able to revoke the option. The *Hott* court held that the option contract was properly revoked before "the payment of independent consideration that would make it an irrevocable option contract."[57] The possibility that the payments were an absolute obligation and, thus, the promise to pay was consideration from the outset was not discussed in the case. Although an absolute promise to pay money would constitute consideration, apparently there was not an obligation to make the series of payments, and the payments were merely conditions to the continuation of the option. In light of this uncertainty, however, the purchaser would want to consider structuring his earnest money contract so that there is always an initial payment of money, in order to avoid dispute about the absoluteness of a future obligation and to furnish the "independent consideration" required under *Hott.*

Problems can arise in connection with the "outs" the purchaser has under various contingency provisions, which allow the purchaser to terminate the contract and thereupon secure a refund of his earnest money. The earnest money paid at the time the contract is entered into could furnish consideration for the option; however, the fact that for a period of time the purchaser may terminate the contract and receive his earnest money back may make the option unsupported by consideration during this period and thus revocable by the seller.[58] Until the earnest money is actually at risk, the seller is not bound. Once the purchaser can no longer terminate the contract without forfeiting the earnest money, the option is then binding upon the seller. To ensure that the option is irrevocable from the outset, how-

57. *See id.* at 853. The court additionally provided:

> While generally the mutual promise to buy and sell are sufficient to create a binding contract to convey land, they are not sufficient when the buyer's liability is limited to forfeiture of his earnest money. The effect of limiting liability results in an option to purchase, revocable at the will of the seller, unless and until an independent consideration is paid.

Id. at 853.

58. *See* Echols v. Bloom, 485 S.W.2d 798, 800 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.).

ever, the practice of having the buyer tender a sum of money which is to be paid to the seller, regardless of whether or not the purchaser exercises its right to terminate the contract, is suggested. Such a course would also avoid the problem of whether the earnest money was intended as an option fee, liquidated damages, or an unenforceable penalty. If a large earnest money deposit is at stake, characterizing it explicitly as an "option fee" may protect the seller from challenges to his right to retain the full amount of the escrow.

A very small consideration can be sufficient to support the promise of an option giver.[59] It is also said that consideration is "sufficient" if it is bargained for.[60] The general rule is that whatever consideration a promisor agrees to is legally sufficient consideration.[61] The danger would seem to exist, however, that if the amount is extremely disproportionate to the size of the deal, the consideration could be attacked as nominal, the contract could be attacked as illusory, and the seller could assert that he is not bound. Some precautions might be helpful, such as reciting in the agreement that the amount was bargained for, why it is appropriate, etc. Care should be taken that the consideration is not merely recited and never paid, for parol evidence will be admissible to show that a factual recitation that a sum was paid is false and that the consideration never actually passed.[62]

The effect of the contingencies and review period on the nature of

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59. *See* Marsh v. Lott, 97 P. 163, 165 (Cal. Ct. App. 1908) (sufficiency of price paid for option not measured by its adequacy); Miller v. Kimmel, 184 P. 762, 765 (Okla. 1919) (weight of authority holds consideration of one dollar adequate for option of reasonable duration); *see also* 1A A. CORBIN, CORBIN ON CONTRACTS § 263, at 500 (1963 & Kaufman Supp. 1980) (one dollar may be sufficient to make option irrevocable); *accord* Teague v. Edwards, 159 Tex. 94, 97, 315 S.W.2d 950, 952 (1958) (promise to pay insurance proceeds sufficient though recovery from insurance might be remote contingency); Hovas v. O'Brien, 654 S.W.2d 801, 803 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.) ("*quid pro quo* is not required to create a valid consideration").

60. *See* 1 A. CORBIN, CORBIN ON CONTRACTS § 127, at 540 (1963); RESTATEMENT (SECOND) OF CONTRACTS § 71 (1981); *see also* Hoffer v. Eastland Nat'l Bank, 169 S.W.2d 275, 281 (Tex. Civ. App.—Eastland 1943, no writ) (for thing to be consideration, one party must offer and the other accept that thing as such).

61. *See* Teague v. Edwards, 159 Tex. 94, 97-98, 315 S.W.2d 950, 952-53 (1958); Hicks v. Smith, 330 S.W.2d 641, 646 (Tex. Civ. App.—Fort Worth 1959, writ ref'd n.r.e.).

62. *See* Higgins v. Mossler Acceptance Co., 140 S.W.2d 532, 536 (Tex. Civ. App.—Galveston 1940, writ dism'd); Radford v. Snyder Nat'l Farm Loan Ass'n, 121 S.W.2d 478, 480 (Tex. Civ. App.—Amarillo 1938, no writ); *see also* 14 TEX. JUR. 3d *Contracts* § 105 (1981). Where a written contract recites the consideration, or states that it has been paid, it is prima facie evidence that the consideration has passed. *See id.* § 105. This evidence may, however, be refuted by parol evidence showing the true consideration. *See id.* § 105.

the contract will become less important if the purchaser recognizes that the earnest money contract is an option and steps are taken to bind the seller. A contingency upon the purchaser's obligation to close may render the contract an option rather than a contract binding on both parties; but a considerable amount of authority supports the proposition that a contingency, such as satisfactory zoning or financing, implies an obligation on the party to use due diligence to bring it about and does not give the party a choice as to whether or not to perform.[63] Although a promise to perform made subject to the wish, will, caprice, or desire of the promisor may be illusory,[64] Texas courts have upheld contracts in which a performance has been made subject to the approval or satisfaction of the purchaser regarding either some aspect affecting the purchaser's ability to perform (frequently title contingency provisions), or the suitability of the property for its contemplated use.[65] The decision of the purchaser exercising such discretion must be made honestly and in good faith. In change to this regard, some courts hold that an objective "reasonable man"

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63. *See* Rhodessa Dev. Co. v. Simpson, 658 S.W.2d 218, 220 (Tex. App.—El Paso 1983, no writ). The court stated:

> We conclude that Rhodessa's contract, which contained a condition precedent and was subject to a zoning change, must be construed to place an implied obligation upon the buyer to use due diligence to obtain such zoning change. Otherwise, the buyer has the added option to sit idly by if it determines that the contract is not advantageous and, when the zoning never occurs, consider the contract terminated without suffering any damages.

Id. at 220; *see also* Langley v. Norris, 141 Tex. 405, 412-13, 173 S.W.2d 454, 458 (1943); Carroll v. Wied, 572 S.W.2d 93, 97 (Tex. Civ. App.—Corpus Christi 1978, no writ). In *Carroll,* the court held that a provision making the contract contingent on the purchaser's ability to obtain a loan implied an obligation on the purchaser to diligently pursue obtaining a loan and that he would have a reasonable time within which to act. *See id.* at 97.

64. *See* 3A A. CORBIN, CORBIN ON CONTRACTS § 644, at 83-84 (1963). Professor Corbin cites the case of Mattei v. Hooper, 330 P.2d 625 (Cal. 1958), for the proposition that a contract for the sale of land containing a provision making the purchaser's obligation contingent on his ability to find satisfactory tenants for the property is not, of itself, illusory. The contract would be illusory, however, if the purchaser's decision was not made honestly and in good faith, or if it was based on "whim, caprice, or a belated opinion that the land was not worth the agreed price." *See* 3A A. CORBIN ON CONTRACTS § 644, at 83-84 (1963).

65. *See* Rhodessa Dev. Co. v. Simpson, 658 S.W.2d 218, 220 (Tex. App.—El Paso 1983, no writ) (contract subject to purchaser obtaining proper zoning); Carroll v. Wied, 572 S.W.2d 93, 95 (Tex. Civ. App.—Corpus Christi 1978, no writ) (contract contingent on purchaser obtaining loan); Campbell v. Hart, 256 S.W.2d 255, 261 (Tex. Civ. App.—Fort Worth 1953, writ ref'd n.r.e.) (contract subject to satisfactory title); *cf.* Black Lake Pipe Line Co. v. Union Constr. Co., 538 S.W.2d 80, 88 (Tex. 1976) (embodies same principle in construction contract where inspector's decision was conclusive as to whether or not job was satisfactorily completed).

standard will be imposed; however, in Texas it has been held that if the party makes an honest, considered determination, it is irrelevant that a reasonable purchaser would have been satisfied.[66]

It may be unnecessary to make the above arguments if the contract has been properly drafted. Even if the contract is subject to the "wish, will, or desire" of the purchaser, if it is already recognized that the contract is an option, and independent consideration (that is, independent of the illusory promise) in the form of a non-refundable option payment has been made at the contract's inception, the *option* is supported by consideration and is binding on the seller.

V. EXAMINING THE PURCHASER-ORIENTED CONTRACT—DRAFTING CONSIDERATIONS

A. *Independent Consideration*

A typical purchaser-oriented contract will frequently provide that the seller may, as his sole remedy, retain the purchaser's earnest money deposit as liquidated damages for the purchaser's failure to close the transaction. This type of provision does not adequately protect the purchaser's interests because, as previously discussed, this limitation of the seller's remedies renders the contract an option.[67] Since the option is not supported by independent consideration, it is merely a continuing offer which may be freely revoked by the seller at any time prior to the purchaser's acceptance.[68] In order to remedy this deficiency, the authors suggest that such contracts employ a provision setting forth the existence of such independent consideration, in a manner similar to the following provision:

Contemporaneously with the execution of this Contract, Purchaser

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66. *See* Campbell v. Hart, 256 S.W.2d 255, 262-63 (Tex. Civ. App.—Fort Worth 1953, writ ref'd n.r.e.). The *Campbell* court held:

> If such a contract be made, the party to be satisfied is the judge of his own satisfaction, subject to the limitation that he must act in good faith. He should fairly and candidly investigate and consider the matter, reach a genuine conclusion, and express the true state of his mind. . . . Having done this, his satisfaction or dissatisfaction fixed the rights of the parties. It is of no consequence that a court or jury might believe that he ought to have been satisfied or that a reasonably prudent purchaser would have been satisfied.

Id. at 262-63.

67. *See* Paramount Fire Ins. Co. v. Aetna Casualty & Surety Co., 353 S.W.2d 841, 843 (Tex. 1962). For further support, see *supra* notes 18-19 and accompanying text.

68. *See* Hott v. Pearcy/Christon, Inc., 663 S.W.2d 851, 853 (Tex. App.—Dallas 1983, writ ref'd n.r.e.). For further support, see *supra* notes 11-12, 47-56, and accompanying text.

> hereby delivers to Seller and Seller hereby acknowledges the delivery of, a check in the amount of Fifty and No/100 Dollars ($50.00) ("Independent Contract Consideration"), which amount the parties bargained for and agreed to as consideration for the seller's grant to Purchaser's exclusive right to purchase the property pursuant to the terms hereof and for Seller's execution, delivery and performance of this Contract. This Independent Contract Consideration is in addition to and independent of any other consideration or payment provided in this Contract, is nonrefundable, and shall be retained by Seller notwithstanding any other provision of this Contract.[69]

The use of the term "Independent Contract Consideration" or a similar phrase, instead of an explicit designation of the sum as an "option fee," may be desirable for bargaining purposes, as some sellers may be wary of an "option," due to its explicit tentativeness, even though they agree to limit their remedy for default to retention of the "earnest money."

B. *Assignment of the Contract*

The right to assign a contract is frequently crucial to the purchaser for a variety of reasons. It is essential to his ability to make a quick profit that he is able to "flip" his rights under the contract to another party with little or no risk. Even if this is not the purchaser's primary objective, frequently he will want to sell or contribute his rights to a limited partnership, which will close the transaction and take title to the property, thereby enabling the purchaser to raise capital through syndication, derive syndication fees, and enjoy tax benefits. Under common law, if a contract is silent as to the issue of assignment, the contract is freely assignable if the obligations it imposes do not entail the personal performance or creditworthiness of the purchaser.[70]

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69. Suggested contractual language used in this article is taken from specific contracts used by the authors in real estate transactions. If the reader chooses to utilize this language, he or she must use extreme care to insure that these provisions do not conflict with any other provisions in his or her contract.

70. *See* Hallman v. Safeway Stores, Inc., 368 F.2d 400, 403 (5th Cir. 1966); Lancaster v. Greer, 572 S.W.2d 787, 789-90 (Tex. Civ. App.—Tyler 1978, writ ref'd n.r.e.); Zale Corp. v. Decorama, Inc., 470 S.W.2d 406, 408 (Tex. Civ. App.—Waco 1971, writ ref'd n.r.e.). When a contract is freely assignable, however, the law in Texas provides that although a party may assign his contractual benefits and obligations, the assignor remains liable for the proper performance of the contractual obligations; also, a provision stating that the agreement shall include and be binding on assignees is not construed to authorize a release. *See* Western Oil Sales Corp. v. Bliss & Wetherbee, 299 S.W. 637, 638 (Tex. Comm'n App. 1927, judgmt adopted); H.M.R. Constr. Co. v. Woolco, 422 S.W.2d 214, 216 (Tex. Civ. App.—Houston

Rather than risk any potential dispute in regard to this issue, the purchaser should secure a contractual provision clearly setting forth the parties' agreement that the purchaser may freely assign the contract. The purchaser should also seek the inclusion of a provision stating that, upon such assignment, the seller shall look solely to the assignee for the payment and performance of the purchaser's obligations and duties thereunder. These concerns are addressed in the following example of such a provision:

> This Contract shall inure to the benefit of and be binding on the parties hereto and their respective legal representatives, successors, and assigns. Either party may assign its rights hereunder at any time at or prior to Closing to any other person or entity. Seller agrees that if Purchaser assigns its rights under this Contract, such assignment will have the effect of fully releasing Purchaser from any and all obligations and duties hereunder without the necessity of further documentation to evidence the same. Notwithstanding the previous sentence, upon any such assignment, Seller further agrees to execute any such documents as Purchaser may require to further evidence that Purchaser has been released from any and all liability with regard to the Contract.

Raising the issue of assignment, however, could be unprofitable because the seller would likely reject such a provision. The most preferable alternative would be to artfully include recitals indicating that the duties and obligations of the purchaser under the contract are not personal in nature, that they may be performed by the purchaser and/or designee, and that no personal liability of the purchaser shall exist with respect thereto. This would enable the purchaser to maintain that the contract is assignable by virtue of operation of law.

C. *Limitation of Seller's Remedies—The Purchaser's Perspective*

It is essential to the protection of the purchaser that the limitation of liability to the loss of his earnest money be clearly and unambiguously articulated. Otherwise, it is possible that a court may decide that the seller can either elect to retain the purchaser's deposit, pursue damages, or seek specific performance (i.e., payment of the full purchase price) against the purchaser.[71] The authors suggest that

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[14th Dist.] 1967, writ ref'd n.r.e.); Potts v. Burkett, 278 S.W. 471, 473 (Tex. Civ. App.—Eastland 1926, no writ).

71. The fact that this is a real possibility and not merely a theoretical danger is amply and dramatically illustrated by two recent decisions by Texas courts of appeal. In 1983, the

such contracts employ a provision setting forth the seller's sole and exclusive remedy in a manner similar to the following provision:

> If Purchaser fails or refuses to consummate the purchase of the Property pursuant to this Contract at the Closing, for any reason other than termination of this Contract by Purchaser pursuant to a right so to terminate expressly set forth in this Contract or Seller's failure to perform Seller's obligations under this contract, then Seller, as Seller's *sole and exclusive remedy,* shall have the right to terminate this Contract by giving written notice thereof to Purchaser prior to or at the Closing, whereupon neither party hereto shall have any further rights or obligations hereunder, and Title Company shall deliver the Earnest Money to Seller as liquidated damages, free of any claims by Purchaser or any other person with respect thereto. It is agreed that the Earnest Money to which the Seller is entitled hereunder is a reasonable forecast of just compensation for the harm that would be caused by Purchaser's breach and that the harm that would be caused by such breach is one that is incapable or very difficult of accurate estimation.

D. *Limitation of Seller's Remedies—The Seller's Perspective*

As previously discussed, the limitation of the seller's remedies to retention of the earnest money deposit, absent independent consideration, creates a revocable option. However, the language which expresses the contemplated limitation on the purchaser's liability may have unintended consequences, since the concept of such limitation is frequently articulated by provisions characterizing the seller's retention of the earnest money as "liquidated damages" for such breach. Such provisions may be subject to subsequent challenges by the purchaser on the grounds that they impose a penalty or forfeiture, rather than constituting a bona fide attempt to fix liquidated damages in the absence of a basis for ascertaining the extent of the potential detriment which would be suffered by the seller in the event of the pur-

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Corpus Christi court held that although the parties struck out two of the three remedies listed, the parties did not intend to provide only one exclusive remedy, as the precatory language reciting that "the landlord shall have the option to pursue any one or more of the following remedies" was not deleted. Consequently, the court held that the remedy expressly provided was permissive, but not exclusive. *See* Bifano v. Young, 665 S.W.2d 536, 537 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.). The Fort Worth court of appeals has held similarly. *See* Ryan Mortgage Investors v. Fleming-Wood, 650 S.W.2d 928, 933 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.) (express remedy not exclusive, buyer could pursue other common law remedies). For further discussion of this point, see *supra* notes 29-33 and accompanying text.

chaser's breach. Since penalties and forfeitures are unenforceable, the purchaser could prevail. The seller would be forced to prove the extent of the actual damages suffered by virtue of the purchaser's breach in the event the provisions for the seller's retention of the earnest money are not deemed to establish bona fide liquidated damages. If the seller is unable to do so, the purchaser would be able to recover the disputed earnest money deposit and, adding an expensive insult to compound the already grievous injury inflicted upon the seller, could also receive attorney's fees.[72] The seller can conclusively avoid any dispute as to the reasonableness of the stipulated damages for breach of the contract[73] by changing the designation of the purchaser's deposit from "earnest money" to "option fee," as the courts will not entertain challenges to the reasonableness of the bargained-for consideration for the option.[74] Hopefully, the seller will be able to persuade the purchaser to agree to this modification by merely expressing solicitude for the purchaser's ability to enforce what is, essentially, an option contract and by reminding the purchaser that this change does not affect the substance of their bargain, but merely reinforces the limited liability of the purchaser. This will also underscore that the decision regarding whether or not to consummate the transaction is solely at the purchaser's option.

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72. *See* TEX. REV. CIV. STAT. ANN. art. 2226 (Vernon Supp. 1985).

73. *See* Stewart v. Basey, 150 Tex. 666, 669, 245 S.W.2d 484, 486 (1952) (where damages stipulated, must be reasonable or not enforceable); American Nat'l Ins. Co. v. Tri-Cities Constr., 551 S.W.2d 106, 109 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ) (damages fixed prior to breach are penalty and unenforceable if not "reasonable forecast of just compensation for the harm . . . caused by the breach"); Brace v. Dante, 466 S.W.2d 66, 69-70 (Tex. Civ. App.—Dallas 1971, no writ) (if provision intended as estimate of damages actually incurred, it is enforceable).

74. *See* Griffin v. Bell, 202 S.W. 1034, 1036, 1037-38 (Tex. Civ. App.—Texarkana 1918, writ ref'd). In *Griffin,* the court held that landowners have the right to convey options on such terms as they see fit and, further, that the consideration need not be both valuable and adequate. The opinion also states that, "where the consideration is sufficient to be denominated 'valuable,' the courts do not concern themselves with the relative value of the properties exchanged." The opinion does state, however, that the general rule is subject to exceptions, such "as where the consideration is so grossly out of proportion to the property conveyed as to shock the conscience." *See id.* at 1037-38; *see also* 1 A. CORBIN, CORBIN ON CONTRACTS § 127, at 540, 542 (1963). Professor Corbin states that "consideration in fact bargained for is not required to be adequate in the sense of equality in value." Corbin also explains that the enforceability of a promise such as this will seldom be affected unless the non-equivalence of this consideration is so gross as to indicate fraud or mistake. *See id.* at 542; *see also* language set forth *supra* text accompanying note 69, which, along with changing the designation of the purchaser's deposit to an option fee, may help in establishing the earnest money as proper and valid liquidated damages.

E. *Limitation of Purchaser's Remedies—The Seller's Perspective*

Frequently, as the *quid pro quo* for the limitation of the purchaser's liability, the contract will limit the purchaser's recourse against the seller, with respect to the seller's failure to satisfy conditions precedent to closing, by imposing upon the purchaser a choice between receiving a refund of his earnest money deposit or accepting such title as the seller may convey. As discussed previously, the *Ryan* case underscores the crucial importance to the seller of clearly specifying that the purchaser is unequivocably barred from pursuing any remedy with respect to any defect of title in the event that the purchaser elects to close.[75] The pertinent provisions should unambiguously declare that, should the purchaser seek to obtain specific performance, the seller shall not be obligated to incur any cost or expense to cure any such defect and that the conveyance by special warranty deed of such title as the seller then holds is to be the purchaser's sole and exclusive remedy, so as to preclude any recourse with respect to consequential or other forms of damages. Since the refund of the earnest money is not a remedy, but merely restores to the purchaser funds which are his own, the authors suggest that the seller agree to pay a specified rate of interest thereon as liquidated damages for seller's breach.

Another aspect of negotiations which a seller should concern himself with is the waiver of protections afforded under the Deceptive Trade Practices Act (DTPA). The recently amended section 17.42 of the DTPA[76] permits waiver of its protections (other than those of section 17.55A) by "a business consumer with assets of $5 million or more . . . that has knowledge and experience in financial and business matters that enable it to evaluate the merits and risks of a transaction and that is not in a significantly disparate bargaining position."[77] Accordingly, the prudent seller should include in his contract such a waiver of the protections and remedies afforded under the DTPA, coupled with the purchaser's warranty, representation, and certification to the seller that the purchaser meets the DTPA's waiver criteria. The seller should additionally prohibit any assignment of the contract to any party that fails to both satisfy the waiver criteria and furnish identical certification to the seller prior to such

75. *See* Ryan Mortgage Investors v. Fleming-Wood, 650 S.W.2d 928, 933 (Tex. Civ. App.—Fort Worth 1983, writ ref'd n.r.e.).

76. TEX. BUS. & COM. CODE ANN. § 17.42 (Vernon Supp. 1984).

77. *See id.*

assignment. In order to remedy any potential DTPA problems, the authors suggest inclusion in the contract of a provision similar to the following:

> Purchaser hereby represents and warrants to Seller, as a material inducement to Seller to enter into this Contract and consummate the transaction contemplated hereby, that Purchaser has assets in excess of $5,000,000. Purchaser hereby waives, to the maximum extent permitted by law, any and all rights, benefits and remedies under the Deceptive Trade Practices Act with respect to this Contract and any matters pertaining to the transaction contemplated hereby.

In addition, the seller's counsel should always strive to clearly articulate and document what information and representations have been furnished or made to the purchaser prior to the contract's execution. Counsel should also provide a process for documenting the content and scope of any subsequent information or representations so as to preclude potential liability under the DTPA, independent of the seller's contractual liability. Similarly, the contract should unambiguously disclaim any liability for any consequential damages. Seller's counsel should also remember, in regard to the items of personalty and fixtures covered by the contract, that express warranties can arise under section 2.313 of the Uniform Commercial Code (UCC), as adopted by the State of Texas,[78] even though, to the seller's mind, a "description" of this property in the contract may not be intended to serve as a warranty or representation. Additionally, implied warranties can arise by virtue of sections 2.314 and 2.315 of the UCC.[79] Thus, the seller's disclaimers should be suitably "conspicuous" and

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78. *See id.* § 2.313 (Tex. UCC) (Vernon 1968 & Supp. 1984): Section 2.313 states:

Express Warranties by Affirmation, Promise, Description, Sample

(a) Express warranties by the seller are created as follows:

(1) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(2) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the sample or model.

(3) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(b) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

Id. § 2.313.

79. *See id.* § 2.314, which states:

clearly worded so as to satisfy the requirements of section 2.316 of the UCC.[80] Furthermore, when representing the seller in conveyances of

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Implied Warranty: Merchantability; Usage of Trade

(a) Unless excluded or modified (Section 2.316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(b) Goods to be merchantable must be at least such as (1) pass without objection in the trade under the contract description; and

(2) in the case of fungible goods, are of fair average quality within the description; and

(3) are fit for the ordinary purposes for which such goods are used; and

(4) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(5) are adequately contained, packaged, and labeled as the agreement may require; and

(6) conform to the promises or affirmations of fact made on the container or label if any.

(c) Unless excluded or modified (Section 2.316) other implied warranties may arise from course of dealing or usage of trade.

Id. § 2.314; *see also id.* § 2.315, which states:

Implied Warranty: Fitness for Particular Purpose

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

Id. § 2.315.

80. *See id.* § 2.316, which states:

Exclusion or Modification of Warranties

(a) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this chapter on parol or extrinsic evidence (Section 2.202) negation or limitation is inoperative to the extent that such construction is unreasonble.

(b) Subject to Subsection (c), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(c) Notwithstanding Subsection (b)

(1) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(2) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

raw land or income-producing properties, the authors regularly use language disclaiming any warranties, in a manner similar to the following provision:

> Except as specifically stated in this Contract, Seller hereby specifically disclaims any warranty, guaranty, or representation, oral or written, past, present, or future, of, as to, or concerning (i) the nature and condition of the Property, including but not by way of limitation, the water, soil, and geology, and the suitability thereof and of the Property for any and all activities and uses which Purchaser may elect to conduct thereon, (ii) the manner, construction, condition, and state of repair or lack of repair of any improvements located thereon, (iii) except for any warranties contained in the Deed, the nature and extent of any right-of-way, lease, possession, lien, encumbrance, license, reservation, condition or otherwise, and (iv) the compliance of the Property or its operation with any laws, rules, ordinances, or regulations of any government or other body. The sale of the Property as provided for herein is made on an "as is" basis, and Purchaser expressly acknowledges that, in consideration of the agreements of Seller herein, except as otherwise specified herein, Seller makes no warranty or representation, express or implied, or arising by operation of law, including, but in no way limited to, any warranty of condition, habitability, merchantability, or fitness for a particular purpose of the property.

Seller's attorney should be aware that, as article 5545 prohibits limitation of the period in which to bring suit to a period under two years, limiting the "survival" of representations and warranties to a lesser period may, ironically, extend them to the four year limitations period applicable to suits for breach of contract, unless the survival limitation is precisely worded to avoid such effect.[81]

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(3) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(d) Remedies for breach of warranty can be limited in accordance with the provisions of this chapter on liquidation or limitation of damages and on contractual modification of remedy (Sections 2.718 and 2.719).

(e) The implied warranties of merchantability and fitness shall not be applicable to the furnishing of human blood, blood plasma, or other human tissue or organs from a blood bank or reservoir of such other tissues or organs. Such blood, blood plasma or tissue or organs shall not for the purpose of this Title be considered commodities subject to sale or barter, but shall be considered as medical services.

(f) The implied warranties of merchantability and fitness do not apply to the sale of or barter of livestock or its unborn young.

Id. § 2.316.

81. *See* TEX. REV. CIV. STAT. ANN. arts. 5527, 5545 (Vernon 1958 & Supp. 1985).

F. *Enhancing the Marketability of the Contract*

A purchaser contemplating selling his rights under the contract to another party, or securing third party financing for his purchase, should ensure that the seller furnishes a current title commitment with legible copies of all referenced title objections, an adequate current survey, and all other relevant information as soon as possible. The purchaser should also insist that the contract provide for suitably lengthy review and inspection periods which expire a reasonable time after all relevant information and materials have been secured. The contract should provide a suitable process for determining the commencement and expiration of review, inspection, and contingency periods, as well as for ascertaining the date for closing, because, as previously noted, strict compliance with the terms of any option is required. Such a provision will enable the purchaser to provide potential assignees or the potential lender with the necessary information in order to induce them to purchase his interest in the contract or make the loan for its acquisition. The purchaser will thereby be afforded sufficient time in which to conduct negotiations and consummate the sale of his interest as purchaser under the contract or the loan to acquire the property.

VI. CONCLUSION

The contracts discussed in this article afford their draftsman the opportunity to employ his imagination and creativity to achieve his client's goals, and thereby ensure to his client the optimum measure of protection available consistent with those ends. To fully achieve these objectives and prevent unanticipated adverse consequences to his client, the attorney must draft and review contracts with sensitivity to, and awareness of, the legal implications which arise from the limitations imposed upon the parties' remedies and the resulting impediments to the realization of his client's goals which may arise. Although most transactions do not engender lawsuits, the authors believe that clients are best served when their attorneys strive to draft their contracts so as to accurately embody the terms of the transaction and enable the parties to enforce and enjoy the benefits of their bargain.