Real Property Law REPORTER

Volume 33 / Number 3 May 2010

CONTENTS

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FEATURED ARTICLES

The 3-Year Aftermath of *Black Hills Invs. v Albertson's*: Recent Developments and Suggestions for Resolving an Asserted *Black Hills* Defense

Randy Sullivan

Introduction

Whether negotiating a purchase agreement for real property that has not been subdivided or litigating the enforcement of the agreement, the attorney should determine whether the contract complies with the Subdivision Map Act (Map Act). As the court stated in *Black Hills Invs., Inc. v Albertson's, Inc.* (2007) 146 CA4th 883, 893, 53 CR3d 263 (*Black Hills*), reported at 30 CEB RPLR 50 (Mar. 2007), if the agreement to sell unsubdivided property affords a party the right to waive the obligation to record a final subdivision or parcel map, then the contract is illegal and therefore void. The buyer then is free from its contract obligation and may demand the return of the deposit.

Black Hills is particularly important in today's upside down, uncertain, and litigious real estate climate. For the homebuilder and developer, land in this market is a liability—especially for the public builder, which must report this liability to its shareholders. Currently, parties are reviewing their pending real property purchase agreements with a careful eye toward language regarding the obligation to record a parcel map. *Black Hills* may provide a defense to a party otherwise in clear breach of an agreement to purchase or sell real property.

The continued uncertainty and fear in the real estate market have led, and likely will lead, to more attempts to assert a *Black Hills* defense. In fact, as Steve Stwora-Hail mentioned in his 2007 article (Stwora-Hail, *Practitioners Beware! The Serious Implications of* Black Hills Invs. v Albertson's, 30 CEB Real Prop L Rep 176 (Nov. 2007)), the failure to adapt purchase and sale agreements to the *Black Hills* decision could be raised in the context of ground leases in commercial retail centers, or even loan commitments.

The author has confirmed through discussions with real estate practitioners that clients are seeking legal advice to review agreements for the applicability of *Black Hills*. A reasonable interpretation that the agreement permits a waiver of the obligation to record a final parcel map may resolve or leverage a settlement of disputed purchase and sale obligations. In both the current declining market, in which buyers may wish to terminate their agreements, as well as a future rising market, in which sellers might be interested in pursuing a better deal, *Black Hills* is likely to be an issue of recurring importance. The number of cases, published and unpublished, involving a *Black Hills* defense is evidence of its significance.

Black Hills and *Sixells, LLC v Cannery Bus. Park* (2008) 170 CA4th 648, 88 CR3d 235, reported at 32 CEB RPLR 56 (Mar. 2009) (both discussed below), involved situations in which agreements contained provisions that purported to waive compliance with the Map Act. There are one published and two unpublished federal district court decisions in which the court rejected a *Black Hills* defense against agreements with analogous language. As in many real property disputes, the application of *Black Hills* to these and future cases depends on the language of the agreements and its interpretation by a particular court.

This article discusses the effect of *Black Hills*, subsequent cases in which the defense has been raised, suggestions for the real property practitioner, and whether *Black Hills* incorrectly ruled that the contract was void rather than voidable.

The Subdivision Map Act and *Black Hills*

Government Code §66410 requires all real property subdividers to design their communities in compliance with general and specific plans and to comply with all conditions of local ordinances. To promote compliance, the Map Act prohibits the sale, lease, or financing of any parcel of a subdivision until an approved map that complies with the law is recorded. Govt C §66499.30(b). Section 66499.32(a) provides that a contract to sell real property that has been divided in violation of the Map Act is "voidable at the sole option of the grantee, buyer or person contracting to purchase." The statutory scheme, however, permits a sale to take place as long as the contract expressly makes the sale contingent upon the recordation of a parcel map in compliance with the Map Act. See Govt C §66499.30(e). The *Black Hills* case arose under this section of the Map Act.

In *Black Hills*, the buyer terminated a real property purchase agreement for the purchase of two parcels of unsubdivided real estate in a shopping center. The contracts gave the seller, Albertson's, Inc., "the right to terminate the contracts 'without liability' in the event Albertson's before the Closing Date, either (1) failed to obtain governmental approvals of the creation of the two parcels or (2) 'waived' the condition in writing." 146 CA4th at 893. After executing the agreement, Albertson's did record a parcel map, but before the scheduled closing date the buyer, Black Hills, terminated the contracts and requested the return of the deposits without expressly referring to the Map Act. 146 CA4th at 888.

The appellate court found that Albertson's had not satisfied the Map Act requirement that an agreement to sell unsubdivided real property expressly condition the sale on approval and filing of a parcel map. 146 CA4th at 892. The court homed in on the illusory obligation regarding compliance with the Map Act. 146 CA4th at 893. On one hand, the agreements required Albertson's to record a map, but on the other, the agreements permit-

ted it to waive that obligation. 146 CA4th at 893. Under the agreements, even if a final map were not recorded, Albertson's could compel performance or retain the earnest money. Thus, the agreements violated the Map Act; they were illegal. Moreover, the court held that the agreements were "*void* rather than voidable ... at the time they were executed." 146 CA4th at 894 (emphasis added).

Sixells, LLC v Cannery Bus. Park

Sixells, LLC v Cannery Bus. Park (2008) 170 CA4th 648, 88 CR3d 235, arose in the context of a rising real estate market in which the seller terminated a real property agreement to pursue a better deal. The buyer, Sixells, then sued the seller, Cannery Business Park, who successfully demurred on the ground that the contract was void. 170 CA4th at 650.

The agreement provided, as a condition precedent, that before the buyer was obligated to purchase the property, a final map was to be recorded. 170 CA4th at 651. The agreement required Cannery to convert four unsubdivided acres into a developable legal parcel. 170 CA4th at 651. However, the agreement also provided that if a condition precedent was not satisfied or waived, then Sixells had the right to terminate the agreement. 170 CA4th at 651. In theory, Sixells could have waived the seller's obligation to comply with the Map Act and enforced the agreement. 170 CA4th at 651.

Sixells raised four contentions that were summarily dismissed on appeal. Although rejected in *Sixells*, such arguments might hold merit if additional facts are present.

- *First,* Sixells argued that the parties did not intend to violate the Map Act. The court rejected this contention, finding no requirement in the statutory scheme that the parties intend to violate the Map Act. 170 CA4th at 654.
- *Second,* Sixells pointed out that any party to a contract may waive provisions created for its benefit. Therefore, Sixells argued, the buyer's contractual right to waive the seller's obligation to comply with the Map Act should not be dispositive. In response, the court stated that "[a]ny attempt to waive" the Map Act's requirements is invalid, especially if it is written into a contract. 170 CA4th at 654.
- *Third,* Sixells stated that the Map Act only prohibits the sale of illegal parcels and was designed to protect buyers. The court again dismissed Sixells's contention, stating that the Map Act's goals are broader than the protection of buyers. 170 CA4th at 654.
- *Fourth,* Sixells contended that the agreement could be saved by severing the void language. This, too, was rejected. 170 CA4th at 655. The court noted that striking the term "waived" from the agreement would not prevent Sixells from completing the transaction without a recorded final map. 170 CA4th at 655. Although the buyer had the right to terminate if a condition was not met, it did not have the obligation to terminate if the properties were not legally subdivided. 170 CA4th at 651, 655. Thus, an illegal sale still could occur; severing the term "waived" would not save the agreement. 170 CA4th at 655. Significantly, the agreement did not obligate the seller, through a covenant, to record a map. 170 CA4th at 655.

Federal Court Opinions Citing *Black Hills*

American Nat'l Red Cross v United Way Cal. Capital Region

In *American Nat'l Red Cross v United Way Cal. Capital Region* (ED Cal, Dec. 19, 2007, No. Civ S–07–1236) 2007 US Dist Lexis 95296 (*Red Cross*), the federal district court ruled that a contract did comply with the Map Act. *Red Cross* involved an agreement providing Red Cross with an option to purchase a parcel that had to be subdivided. A subsequent owner of the property decided to sell the building to a third party (Volen) and asserted that Red Cross could not exercise its option. Red Cross filed suit. Volen moved to dismiss on the ground that the agreement was void because it failed to comply with the Map Act. 2007 US Dist Lexis 95296, *6. Volen argued that because the option gave Red Cross the right to approve or disapprove the conditions of the parcel map, Red Cross had a right to waive compliance with the Map Act.

The court noted that the original agreement stated that recording the parcel map is a condition precedent to the close of escrow. 2007 US Dist Lexis 95296, *11. The court also found that the seller agreed to record the map and that the seller would be in breach if it failed to do so. Therefore, the agreement was satisfactorily "expressly conditioned" on the recording of the map. 2007 US Dist Lexis 95296, *13. The court distinguished *Black Hills* based on the fact that in *Black Hills*, "recording the map was a condition precedent, *but was not a covenant*" (2007 US Dist Lexis 95296, *13 (emphasis added)) and cited *Black Hills* (146 CA4th at 893). This distinction is critical because a condition precedent may be waived, but a covenant is an obligation to perform that may not be excused. See 1 Witkin, Summary of California Law, *Contracts* §778 (10th ed 2005). As to waiver, the district court ruled that the agreement provided Red Cross with a right only to approve the conditions of what would ultimately become the final parcel map, which did not amount to the right to waive the requirements of the Map Act. 2007 US Dist Lexis 95296, *15. Consequently, the court held that the agreement complied with the Map Act.

Stonebrae, L.P. v Toll Bros., Inc.

Stonebrae, L.P. v Toll Bros., Inc. (ND Cal, Jan. 30, 2009, No. C–08–0221) 2009 US Dist Lexis 11196 involved a failed real property agreement for the purchase of 56 residential lots for almost $32 million. In defending against the action for breach of contract, Toll Bros., the buyer, alleged that the agreement permitted waiver of the Map Act's requirements. The seller, Stonebrae, moved

to strike the affirmative defenses of Toll Bros. that were based on *Black Hills*.

Section 6.3 of the agreement provided that the conditions precedent to the close of escrow were for the benefit of both the buyer and seller and that the "conditions may be waived only by written waivers executed by and exchanged between" buyer and seller. 2009 US Dist Lexis 11196, *4. Under this section, the agreement afforded the buyer the right to terminate the agreement if, after a map was recorded, there was an appeal, and: "If the resolution of such appeal or challenge materially adversely affects the Lots and such resolution is not satisfactory to Builder in Builder's reasonable judgment, *then Builder may terminate this Agreement by notice to Stonebrae within ten (10) days after Builder's receipt of notice from Stonebrae describing such resolution.*" 2009 US Dist Lexis 11196, *4. (Emphasis added.) Toll Bros. contended that this waiver right applied to both the seller's obligation to record a map and the finality of any appeal on the map. Stonebrae, in contrast, contended that the agreement only granted a waiver of the finality of an appeal of any approved final map. The district court reasoned that the provision was reasonably susceptible to Stonebrae's interpretation in light of a number of other provisions in the agreement that contemplated the recordation of a final map. See 2009 US Dist Lexis 11196, *13. These provisions included:

- Stonebrae was to convey fee title, which would not occur without a final map.
- The property was defined as a "Second Final Map."
- The form grant deed attached to the agreement described the property as being recorded with blank spaces for the tract map information to be inserted.
- The title company was to issue Toll Bros., at Stonebrae's expense, an ALTA owner's policy of insurance "in an amount equal to the Purchase Price, showing title to the Property, vested in Builder in *fee simple*." 2009 US Dist Lexis 11196, *15. (Emphasis added by the court.)

Because the provision Toll Bros. was relying on was ambiguous and because the agreement was reasonably susceptible to Stonebrae's interpretation, the court selected the interpretation that was lawful. 2009 US Dist Lexis 11196, *17.

Toll Bros., Inc. v Lin

In *Toll Bros., Inc. v Lin* (ND Cal 2009) 615 F Supp 2d 1100, an action with facts and issues similar to *Stonebrae, L.P. v Toll Bros., Inc.*, Toll Bros. sought to avoid an obligation to purchase 51.2 acres of land for $63,750,000. This obligation was the last of three closings under a single purchase agreement for a total of 147 acres. Toll Bros. closed on the first two closings. Despite having performed two-thirds of the agreement, Toll Bros. contended that the agreement failed to comply with the Map Act, relying on *Black Hills* and *Sixells*.

Toll Bros. based its argument on a single provision in the agreement granting the buyer, Toll Bros., the right to waive one or more of its closing conditions. One of the buyer's closing conditions was that the seller was to record a map. 615 F Supp 2d at 1118.

However, the district court found that §3.2 of the agreement, entitled "Parcel Map to Create Legal Parcel," contained a separate obligation to record a map to create legal parcels that complied with the Map Act. 615 F Supp 2d at 1118. Because this separate obligation was not part of the buyer's closing conditions, the court determined that Toll Bros. could not waive that obligation. 615 F Supp 2d at 1119. In addition, Toll Bros. also could not waive §5.3.2(a) of the agreement, which specified a special closing condition for the final closing, requiring that the property be conveyed pursuant to an "Approved Map." 615 F Supp 2d at 1119. Thus, the court concluded that the agreement was distinguishable from the agreements in *Black Hills* and *Sixells*, in which the obligation to record maps could be waived. 615 F Supp 2d at 1119.

A Framework for the Transactional Lawyer

Real property purchase agreements commonly use waiver provisions to ensure that an agreement will not fail on account of the delayed performance of certain obligations. In the current market, not many real estate purchase agreements are being drafted. When the market begins to turn around, there will be some risk that old agreements containing provisions creating express or latent *Black Hills* issues might be used as models for new transactions, with untoward results. The real property practitioner might unwittingly leave a waiver right in another section of the agreement. To avoid such problems, the practitioner should resolve issues directly. For example, concerns about unexpected delays could be resolved by using a reasonable right to extend escrow provision.

The federal cases discussed above provide a framework for avoiding a *Black Hills* defense. The starting point for the purchase and sale of property that is not yet subdivided is resolving who will bear the Map Act obligation and its costs. Depending on the nature of the parcels to be subdivided and the circumstances at the local governmental agencies, the Map Act obligation may be too great a financial burden or unpredictable an outcome for an unsophisticated seller to assume. Similarly, depending on the circumstances, a public builder simply may be unwilling to assume that obligation.

Purchase Agreements in Which the Seller Is to Secure the Final Map

A seller willing to assume the obligation and risk of Map Act compliance likely can demand a higher sales price. Under those circumstances, to avoid the *Black Hills* defense, the seller should consider including in the

agreement a covenant that the seller will secure a final map, in addition to providing that a final recorded map is an express condition of closing. As in *Toll Bros., Inc. v Lin*, such a covenant should be enforceable.

For clarity, the drafting attorney should put the Map Act obligation in a separate covenants section with language to the effect that the seller absolutely and unconditionally covenants to create a legal parcel prior to selling the land to buyer, and that neither party may waive the covenant under any circumstance, even through mutual consent. The agreement should also state that failure to create a legal parcel constitutes a breach of the agreement and will cause the sale not to proceed.

The downside of this provision for the seller is that, if the property is not subdivided by the close of escrow, there is a risk the seller will lose not only the sale but the investment made in the property. This is a significant risk, especially in large scale real property purchases with long escrows and a substantial amount of work, such as the construction of improvements before the sale. In this situation, a waiver provision might be tempting. Instead, based on *Black Hills*, the seller should include a provision for a reasonable extension of escrow based on the failure to secure a final map by the scheduled close of escrow date. See *Peak-Las Positas Partners v Bollag* (2009) 172 CA4th 101, 106, 90 CR3d 775, reported at 32 CEB RPLR 85 (May 2009) (unreasonable for seller not to grant 2-year extension so that buyer, who had paid substantial deposits, could complete lot line adjustment).

Purchase Agreements in Which the Buyer Is to Secure the Final Map

Ordinarily, a buyer will not want to covenant to secure the subdivision of real property due to the uncertainties and unforeseeable costs. If the buyer does assume the Map Act obligation, the buyer will want the obligation to be in the form of a condition rather than a covenant. Without the protection of a covenant, a *Black Hills* defense is more likely to apply. It becomes critical to avoid any waiver language tied to the condition and to expressly provide that the sale simply may not proceed if the condition is not satisfied.

Another issue arises from the possibility that an opposing party may contend that the purchase and sale agreement is a disguised option unsupported by consideration. See *Steiner v Thexton* (2010) 48 C4th 411, 226 P3d 359, reported on p 64 of this issue. In an effort to avoid the disguised option issue, the agreement could provide that the buyer will make commercially reasonable efforts to secure the subdivision of real property and that if such efforts cease, the agreement is terminated, leaving the seller free to sell the property to another party. A more conservative possibility, if the seller agrees, is for the buyer to pay a nonrefundable deposit that will not be applied to the purchase price, thereby providing the element of consideration.

Other Suggested Provisions to Avoid a Waiver of the Map Act

Although the parties' intent to comply does not establish Map Act compliance (see *Sixells*, 170 CA4th at 654), the drafting attorney should still include in the agreement details evidencing that the parties intended to comply with the Map Act. The drafting attorney should define the land to be sold as legal parcel(s), attach a grant deed that describes the property as recorded and that provides a place to designate the final tract map number, and require the seller to provide fee title at the close of escrow.

Did *Black Hills* Incorrectly Decide the Agreement Was Void Rather Than Voidable?

Setting aside the above discussion, it could be argued that the court in *Black Hills* (146 CA4th at 893) incorrectly decided that a contract in violation of the Map Act is void. In ruling that a contract that violates the Map Act is void, the *Black Hills* court initially focused on a key distinction in the statute's construction. Specifically, the court noted that Govt C §66499.30 "does not expressly provide a remedy to a buyer who has entered into a real property sale transaction that is prohibited under that section." 146 CA4th at 891. Then, the court pointed out that the remedies for violations of the Map Act are found under Article 2 (Govt C §§66499.32–66499.36). 146 CA4th at 891.

Under Article 2, Govt C §66499.32(a) explicitly states that a contract is "voidable at the sole option of the grantee, buyer or person contracting to purchase [Black Hills] ... within one year after the date of discovery of the violation...." Notwithstanding this express language, the court in *Black Hills* declared that the contract did not comply with §66499.30 and was void. 146 CA4th at 895. However, the conclusion that the contract was void did not include an analysis justifying this finding.

The finding of the *Black Hills* court appears contrary to the statutory intent. Whereas §66499.32 is under the article on remedies and does use the term "voidable," the section relied on by the court merely describes prohibited transactions and does not use the term "void." No code section other than the sections in Article 2 provides for remedies of a violation of the Map Act. Indeed, Govt C §§66499.33 and 66499.34 provide specific remedies for the governing body, and Govt C §66499.35 provides additional protection for a private party. By declaring a contract void for a technical violation (which, in *Black Hills*, Albertson's had cured by recording a map), the court harshly penalized one party and granted a windfall to the other, reneging party. For these reasons, the author believes that an agreement that violates the Map Act should be voidable, and not void.

This distinction is important because a voidable contact is void as to the wrongdoer, but not void as to the wronged party, unless the wronged party so elects. See Restatement (Second) of Contracts §7 (1981). As a re-

sult, if a party did not record a final map, then that party could not enforce the agreement. However, there are a number of circumstances under which a voidable contract should be enforced in a real property purchase agreement, provided a final map is recorded. For example, if the seller is obligated to secure a final map, but also may waive that obligation, then as long as a final map is recorded, the buyer or the seller should be permitted to elect to enforce the agreement against the other.

For another example, a voidable contract may be ratified by the conduct of the parties. Such an argument might apply in a case such as *Toll Bros., Inc. v Lin*, in which two-thirds of the property to be sold had already been purchased. In addition, a voidable provision may be severed from a contract. See CC §1599. An agreement that includes a separate obligation to record a final map (unlike the agreement in *Sixells*) could be saved by severing the waiver clause. In essence, if two clauses of an agreement conflict, the court should choose the lawful interpretation, as the court did in *Stonebrae*.

Conclusion

There are sure to be further developments and clarifications on the *Black Hills* defense in the coming years. As these cases illustrate, regardless of the direction of real property values, there will be reasons for buyers or sellers to avoid real property agreements. Going forward, the transactional lawyer can avoid this issue altogether by ensuring that the agreement does not provide any room for either party to argue that there is a right to waive any obligation to comply with the Map Act. The litigation attorney can address a *Black Hills* issue by focusing on the classic rules of contract interpretation.

NOTE: The author's law firm represents the Lin Family in *Toll Bros., Inc. v Lin* (ND Cal 2009) 615 F Supp 2d 1100 (review pending in the Ninth Circuit), which is discussed in this article. The views expressed are those of the author and not those of CEB.

The author would like to acknowledge Stephen McNichols for contributing to the analysis for this article.

CEB's New Bankruptcy Book

Roger Bernhardt

California Real Estate Bankruptcies: Law and Litigation (Cal CEB 2010)

I was apprehensive when I heard that CEB was publishing a book on real estate bankruptcies, since—being an unavoidable crossover work—I was not sure that it could do the job. In general, real estate attorneys dislike having to think about bankruptcy matters as much as bankruptcy attorneys dislike having to explain things to real estate counsel (especially when they represent secured lenders). Indeed, most bankruptcy books and articles that cross my desk are largely incomprehensible to me because they were so visibly written for bankruptcy, rather than real estate, readers.

So I was quite pleased to learn that I could follow what was in this new publication. It does look to me like it was written for real estate readers who need to learn what is going on because someone in a transaction has gone insolvent. Thus, the major chapter headings of "Residential and Commercial Leases," "Lease Credit Enhancements," "Mechanics' Liens," and "Real Property Secured Loans" let one go quickly to the most commonly needed topics.

While I regret that I could not find a chapter on personal property (Article 9) secured loans, that I did not know in advance what I should expect to find in the "Claims" chapter, and that I was surprised to come across preferences and fraudulent transfers in the chapter labeled "Property of the Estate," nevertheless, the book itself seemed pretty helpful. Its text gave me intelligible answers to the questions I pretended to ask myself, although I admit to not having enough expertise in those matters as to be able to pass judgment on the merits.

MIDCOURSE CORRECTIONS

The Cost of Free Looks—Ruminations on *Steiner v Thexton*

Roger Bernhardt

Background

Because real estate purchase transactions inevitably begin with a contract of sale between the parties, what the California Supreme Court says about the rules of contract formation is fairly important to the real estate community. The supreme court has spoken quite a bit in these past few years, although I have regarded its pronouncements as constituting a rather mixed blessing. For instance, in *Patel v Liebermensch* (2008) 45 C4th 344, 86 CR3d 366, reported at 32 CEB RPLR 60 (Mar. 2009), when it advised the bar that a sales contract can be specifically enforced even though it fails to specify the manner and time of payment, because those components can be implied, I thought that not only entirely conformed to the traditional rules but also made matters easier for attorneys when called on to advise their clients whether the handwritten notes they had exchanged with their counterparties did or did not constitute enforceable contracts. See Bernhardt, *The Editor's Take,* 32 CEB RPLR 60 (Mar. 2009).

On the other hand, when the court held, in *Sterling v Taylor* (2007) 40 C4th 757, 55 CR3d 116, reported at 30 CEB RPLR 54 (Mar. 2007), that a memorandum that was ambiguous as to the price could be helped by extrinsic evidence in one direction but not the other, I brooded that its ruling worsened rather than improved predictable