

# Contingencies and the Contracting Process

**Here's a broker's guide to traps and triumphs in the latest contracting procedures.**

*Douglas M. Bregman  
Peter G. Miller  
Silver Spring, Maryland*

Because real estate transactions have grown more complex over the past several years, contract modifications have become an integral part of almost every sale.

The new contracting procedures and trends that have emerged raise several significant issues for today's real estate practitioner. For example: Should brokers or salespeople modify sales agreements, or is this the exclusive domain of lawyers? Why is it that so-called "model" or "standard" contract forms have only limited value in most current transactions? What constitutes a "proper" contingency? And how should brokers address the new contracting trends?

## **Who Should Prepare Contracts?**

By definition, a real estate contract is a legally enforceable agreement that defines and describes the roles and obligations of each party to a sales transaction. If additional material is attached to and made a part of the original contract, the contract then contains "addenda." A "contingency" is a provision put in a contract that requires the completion of a certain act or the happening of a particular event before that contract is binding.

If a real estate contract must conform to all relevant legal requirements, then who is allowed to prepare this document and its modifications? Also, what constitutes the preparation of a contract?

The answers to these questions vary from state to state. According to a recent study funded by the Department of Housing and Urban Development (HUD), real estate brokers and salespeople in many states are expressly prohibited from preparing real estate contracts and addenda. In other state jurisdictions, brokers are authorized to prepare only "simple instruments"- that is, basic outlines that include only fundamental information, such as the names of the parties, the date of sale, pricing terms, and a settlement date. In these instances, only an attorney can draw up the contract and its addenda.

Some state jurisdictions, however, view the preparation of a sales contract as "incidental" to the real estate brokerage business and allow a little more freedom. These jurisdictions give express authority to brokers and their salespeople to assist in the contracting process as an element of the service they provide to buyers and sellers.

In all cases, brokers and salespeople must follow the dictates of the laws and regulations in the states where they practice, and should consult an attorney if they have any questions about their role and authority in the contracting process.

Regardless of the functions and duties ultimately delegated to brokers in the contracting process, real estate practitioners should familiarize themselves with new contracting procedures and trends.

### **Role of Standardized Contracts**

Model real estate contracts have been developed to meet the specific needs of virtually all cities, counties, and states. These forms give a full and proper description of the property, the particulars of the transaction (such as price and deposit), and any specialized information required by the jurisdiction in which the property is located.

Standardized contracts can range from brief forms that do little more than meet local legal requirements to sophisticated model documents. Sometimes a given jurisdiction will have several "standardized" and legally acceptable contract forms--some oriented toward the buyer, others toward the seller, and some toward both.

Often the broker or salesperson provides the basic contract document. The selection of a given form with its particular provisions and language is an important step in the bargaining process.

Contracts can be modified in either of two ways. First, basic contract language can be amended by crossing out certain material or inserting new words. Such changes, which must be initialed and dated by all parties to the transaction, may significantly alter an agreement.

For example, one standardized contract form commits a purchaser to pay a given rate of interest "or the lowest rate obtainable"-a phrase that may obligate a buyer to incur unexpectedly large credit costs. This phrase, however, can be eliminated or replaced with language that establishes an interest ceiling above which the buyer is not obligated.

Second, forms may be revised through the use of addenda or contingencies. New material is introduced to replace, negate, augment, or explain unacceptable or incomplete contract language. Perhaps the most common example of a contingency in use today is an addendum that outlines a complicated creative financing transaction by including specific provisions regarding loan prepayments, changing interest rates (if any), balloon payments, and other matters.

### **When to Use a Contingency**

The improper use of contingencies can have grave consequences for brokers, salespeople, and attorneys. To limit liabilities, these three tests can be used when considering the use of contingencies:

1. Does the suggested addendum or contingency meet the precise needs of the buyer/seller? Brokers and attorneys, when not principals themselves, work for one party of the transaction. As contingencies are developed, thought should be given to the specific goals, intent, and motivation of the buyer or seller.
2. Is the suggested language and format consistent with the requirements of the transaction? Proper care must be taken to avoid constructing a contingency that violates public policy or contradicts the

understandings of the parties to the sale. The language of the addendum or contingency should mesh properly with the basic contract document.

3. Does the contingency conform with all relevant legal requirements applicable to the sale? In addition to those legal matters that directly affect real estate transfers, such as statutes and regulations dealing with subjects like usury or zoning, there may be other legal concerns peripheral to the basic transaction. For example, what if the sale is associated with a divorce or the disposition of an estate? What if court approval is needed? What if the interests of minors are involved? These and other issues must be carefully addressed and reviewed.

### **Elements of a Proper Contingency**

Although contingencies can be written in a variety of formats, brokers, salespeople, and lawyers should consider the following central concepts whenever preparing or reviewing addenda:

- How is the addenda attached? A sentence added to a contract or an additional paragraph signed by all parties may seem to change the meaning of the agreement. Therefore, be sure to look at the significance of a contingency within the overall context of the contract. Consider the issues raised-and clarified-in this sample paragraph of attachment:

"This Addendum made and entered into this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, is attached and/or made a part of the Agreement/Contract/Offer dated \_\_\_\_\_ 19\_\_\_\_, between \_\_\_\_\_ Purchaser, and \_\_\_\_\_ Seller, and shall have the same binding force and effect on all parties hereto as does the Agreement/Contract/Offer, and shall take precedence over any and all conflicting or contrary language contained in the Agreement/Contract/Offer to which this Addendum is attached and/or made a part, or any prior addendum or addenda attached and/or made a part thereto, and states as follows:"

This paragraph is worded to resolve a number of issues before they arise. Note that it identifies the parties to the sale, has the same "binding force and effect" as the basic contract agreement, and "take(s) precedence over any and all conflicting or contrary language" found either in the basic contract or in any other addenda or addendum that may have been previously added to the original agreement.

- Is the wording appropriate? Remember that legal wording, having been established over time, may have an entirely different meaning when used in everyday conversation. Material originating from or reviewed by an attorney must use acceptable legal wording. Likewise, material prepared by a broker in the contracting process will be held to the same standard in the event of a dispute. Thus, brokers and salespeople should recognize the responsibility--and potential liability--they may take on by amending standardized contract forms.

- Will the language remain valid? In a real estate sale, the contract between the parties is commonly merged into the deed at the time the title is transferred. However, under certain circumstances it may be desirable for the contract language to remain in effect even after the deed is recorded. For example, a contingency might use the following language in order to avoid merger and ensure its continued validity: "The provisions of this Addendum shall not be extinguished by the merger of the deed of bargain and sale but shall expressly survive the transfer of subject property."

- Is the language specific? All parties to a transaction benefit when the terms and conditions of the agreement are made clear. Stipulate precise times and dates, names, places, amounts, and require-

ments. Avoid problems caused by a contingency that, for example, provides a buyer with a five-year option to acquire an adjoining parcel of property but does not state when the option period will begin.

## **Contingencies and Addenda**

A common type of addendum is one that makes the underlying contract contingent upon the satisfaction or review of a particular party. Examples of this type of contingency include requirements for an acceptable structural inspection of the property, review of the contract by an attorney, or reliance upon a satisfactory appraisal. The following is an example of an appraisal contingency:

"This offer is contingent on an appraisal which, in the sole judgment of Purchaser, is deemed 'satisfactory.' Such appraisal shall be arranged and paid for by Purchaser and if Purchaser does not remove or act on this Addendum or notify Seller or Seller's agent in writing by \_\_\_\_M (Time) on \_\_\_\_\_ (Date) of any dissatisfaction associated with subject appraisal, then this Agreement/Contract/Offer dated \_\_\_\_\_ shall be in full force and effect. A copy of all written appraisal reports, if any, shall automatically be provided to Seller or Seller's agent by, and at the expense of, Purchaser. If Purchaser or Purchaser's agent notifies Seller or Seller's agent by the time and date specified in this paragraph that subject appraisal is unsatisfactory, then this offer shall be null and void and the deposit of the Purchaser, if any, shall be returned in full."

Another category of addenda includes notices that alert the parties to existing or potential issues of contention. If properly written, such notices may limit future claims. Consider this notice of property condition:

"The Purchaser understands that he/she/ they is purchasing property 'AS IS' and that the Seller and Seller's agents make no representations whatsoever as to the condition of the structure being sold; that any express or implied warranties have been made verbally or in writing; that the premises can be used for any particular purpose; that the structure meets necessary building standards; or that appropriate licenses, permits, or easements are or have been recorded or obtained."

Prepared Contingencies just as standardized contracts have evolved on a local basis, it's also possible to develop standardized contingencies. The best candidates are addenda with the broadest possible application. Such model addenda offer several advantages to the real estate broker or salesperson.

Many times real estate contracts and related addenda are prepared by hand under deadline pressure. Errors and omissions frequently can occur in the laborious process of manually writing out forms. Forms photocopied from a model can offer an efficient and easier alternative in many real estate transactions.

Prewritten addenda also provide an institutional advantage to real estate companies that employ many salespeople. If prewritten addenda are available, chances are that everyone will use the same script and thereby avoid the confusion and danger of ad hoc contingencies. The issue of standardization is also important to multiple listing services where agency/subagency relationships exist.

In addition, prewritten contingencies that are organized by subject can be used as a training manual in real estate classes as well as a practical resource in the field once training is completed.

It should be clearly understood that prepared contingencies, although valuable in many cases, are

not appropriate in all instances. By their very nature, real estate transactions are unique, and one must carefully consider the facts and circumstances in each situation before using prewritten forms. In several instances, the selection of the appropriate legal form has been found to constitute the practice of law. Thus, in some jurisdictions a real estate broker or salesperson can be found to be practicing law when he selects one form over another.

The judgment and wisdom of the professional user are paramount; it is his or her responsibility to assure that the language of the form and all particulars are correct, appropriate, and within the context of the specific transaction.

## **Contingencies and Brokerage**

Although contingencies are designed largely to enhance the negotiating posture of buyers and sellers, such clauses have potential value to brokers and salespersons as well. Today, members of the brokerage community are faced with an ever-increasing volume of litigation. Therefore, it is imperative that real estate practitioners understand and use the contracting process for their own protection.

In many instances, language that is of value to a broker can be incorporated into material designed to benefit a buyer or seller. For example, a seller may have a right to obtain the purchaser's credit report. Model language might say that "Neither Seller nor Seller's agent shall be liable for any statements, reports, or documents included in, or resulting from" the report, thereby protecting both the seller and the broker or salesperson.

Sometimes, however, the interests of the broker will be decidedly distinct from those of the principals to a sale. In such cases, a broker has an understandable right to protect his interests in the transaction, because he may later be held responsible for acts, errors, or omissions.

For instance, it's important to definitely establish the relationship between the broker and the principals to a sale in order to avoid future claims of "dual agency," a condition whereby the broker's loyalty to a client is questioned. This is an area of growing concern and should be handled with caution by brokers and salespeople alike.

Brokers have an obligation to the principal who pays the commission, and must explain the agency relationship openly so the buyer/seller understands his position in the marketplace. In addition, salespeople or brokers should probably clarify their agency relationship in the actual contract itself.

## **Avoid Unnecessary Risks**

This article was written to describe and discuss some of the new trends in the contracting process. The material presented above merely highlights general trends and therefore cannot address questions that individual brokers and salespeople may have on contracting procedures. For more information specifically tailored to your practice and jurisdiction, consult a competent professional person in your area.

**Editor's Note:** Some of the material contained in the above article was excerpted from the manual *Model Contingencies for Real Estate Sales*, which is available from the authors.

Mr. Bregman is an attorney specializing in real estate law. REALTOR Miller is an associate broker at James J. Hall, Inc., REALTORS®, and is a weekly columnist for *The Washington Post*.

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