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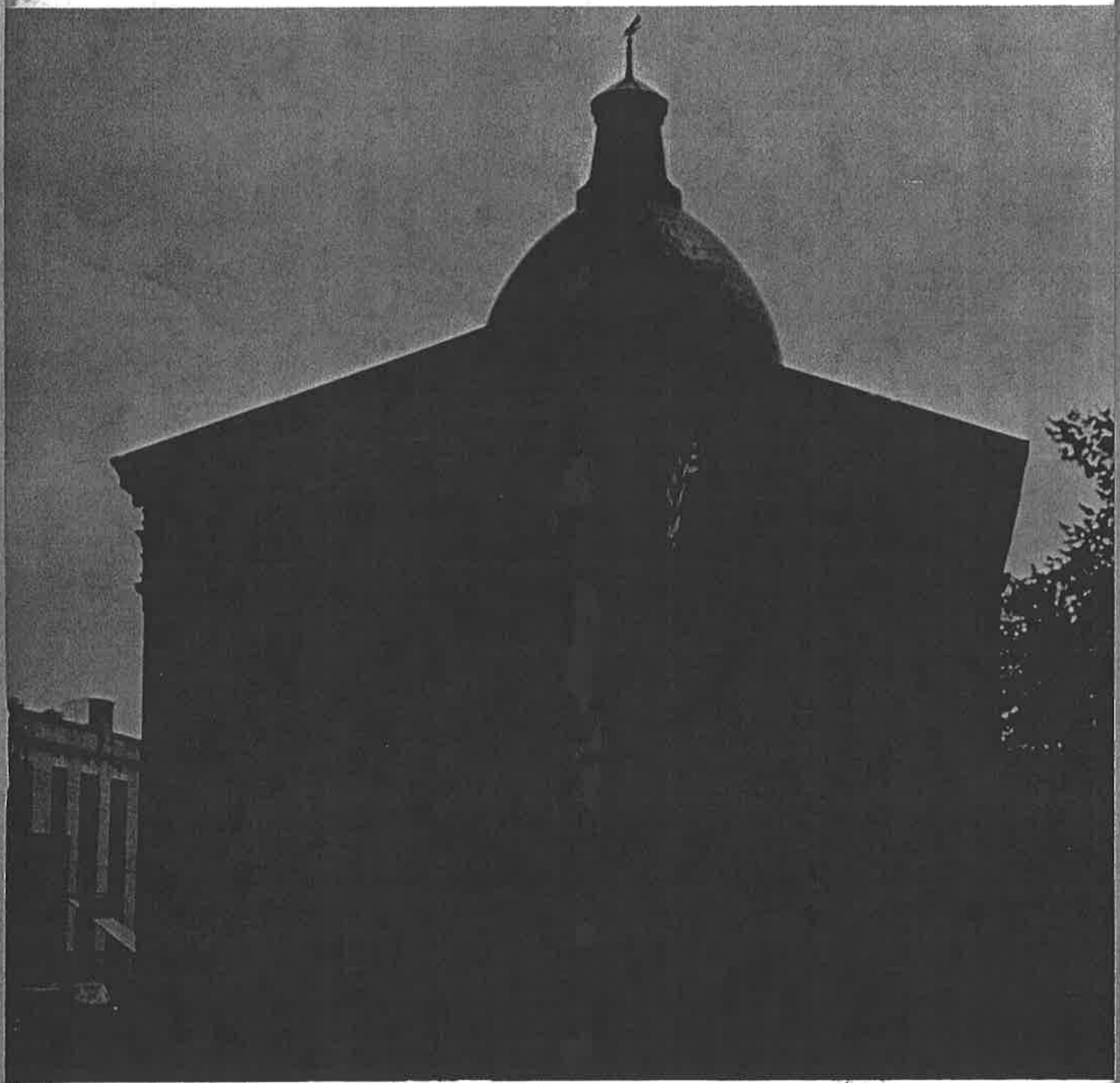

Real Estate Binders—Lawyer Beware

Bruce J. Bergman
Garden City

A graduate of Cornell University and Fordham Law School, the author has written widely in the fields of Construction and Real Estate Law and is a member of the Board of Editors of *the Nassau Lawyer*. He is Chairman of the Real Property Law Committee of the Nassau County Bar Association.

One of the significant times in any negotiations is when the parties "have reached a meeting of the minds" and so can bind each other to their respective obligations. Binder agreements are therefore important in lawyers' thinking. This article indicates some of the pitfalls involved in the use of real estate binders.

Introduction—The Authorities Say No

Many, if not most typical real estate transactions begin with a document generally known as a "Binder"—a dangerous piece of paper which has been a source of considerable confusion, dissatisfaction and litigation. Nevertheless, brokers insist upon it because it is viewed as a means to secure a commission. The seller insists upon it to "insure" his sale. The buyer demands it to "preserve" his purchase.

But the binder often will *not* accomplish the end desired by broker, seller and buyer and knowledgeable attorneys and real estate writers unanimously warn against signing them.

Milton Friedman, in his widely used text "Contracts and Conveyances of Real Property", refers to binders this way:

> "Unfortunately, it is with these (binders) that so many of our transactions begin. When they are enforceable as contracts they are apt to bind a party before he can think twice about a proposal to see his lawyer. Sometimes they are enforceable, sometimes they are not, and often they are so doubtful that nobody can confidently predict their effect until the outcome of a lawsuit. In no case are they satisfactory."

It has been stated another way by no less an authority than James Pedowitz, former Vice President and Eastern Regional Counsel for the Title Guarantee Company and Pioneer National Title Insurance Company, who noted in a lecture some years ago that:

> "The problem with binders . . . is that if it is unenforceable it is unsatisfactory, if the client wants it enforced. It is certainly unsatisfactory from the attorney's point of view when he cannot with confidence advise his client as to the exact legal effect of the particular binder, without resort to expensive and lengthy litigation. Not in the least, a binder almost never covers all of the terms and provisions that an attorney for a seller or a buyer would prefer to have, let alone insist on having, in a well prepared contract of sale."

In Alexander Bicks' PLI monograph "Contracts for the Sale of Realty", as revised by Herman M. Glassner and William M. Kufeld, the admonition was that:

> "It cannot be emphasized too strongly that clients—both sellers and purchasers—should be urged not to sign binders. As prepared by many realtors, they may be complete enough in setting forth the details of the proposed sale, so that a court will enforce them as contracts. In such cases, the parties will have been deprived of an opportunity to include the clauses necessary for their protection. Clients may realize too late that they will be bound to perform a contract unwittingly executed."

Even the document's description should be a source of suspicion. If it actually "binds", should it not be referred to as a "short form contract," because that it just what it would be? And if there is no binding effect, are the possible moral computations, tenuous and ephemeral at best, worth all the trouble?

Still further, binders, almost invariably prepared by brokers, cite the broker as the procuring cause of the transaction and provide for the payment of a broker's commission. Even without such language in a binder, the signing of the binder can be substantial ammunition supporting a broker's claim to commission earned, although the deal collapses—something competent counsel would not otherwise countenance since he would cause to be signed an appropriate commission agreement before any contract is executed.

Yet, in spite of all the sage advice, the potent pitfalls and a variety of other factors militating against binders, prospective sellers and buyers, aided by the entreaties of brokers, continue to demand them.

Preliminary Requisites

When a lawyer prepares a contract of sale, while there may always be room for questions of interpretation, it would be most unlikely that an unenforceable document would emerge. With anything less than a "full contract" as that concept is generally understood by attorneys, there is more room for doubt—which is probably the primary problem with binders and like attempts to seal a bargain for realty.

An overview of some of the basic critical aspects of an agreement is as follows:

—Pursuant to the Statute of Frauds there is a general requirement that a contract of sale, or a note or memorandum thereof, be in writing.

—The signature is to be by the principal or an authorized agent. (Care must be exercised as to the expression of the agent's authority in different jurisdictions. For example, in New York, the agent's authority must be writing, while in Rhode Island it may be granted by parol.

—The agreement need not be in the "form" of a contract.

—An agreement can be complete even though blanks for a broker's name and amount of commission have not been filled in.

—More than one writing can be interpreted together to satisfy the Statute of Frauds. (But there is often the difficult problem of whether the writings constitute an offer and acceptance or an offer and a counteroffer. In addition, where the parties have signed different pieces of paper, there is the issue of whether they've agreed upon the same things.)

The Problem Areas

Qualifying Language

Assuming the hornbook requisites have been satisfied, there is a particularly thorny problem of qualifications added to binders which either render them essentially useless or just questionable. Neither situation is productive.

For example, subjecting the binder to "details to be worked out", (so long as it contained the basics: parties, subject matter, mutual promises, price and consideration, discussed *infra*.) in one jurisdiction at least was held to have no effect on the otherwise valid agreement. If there was later a disagreement on those "details", one of the parties will be saddled with something he would not have agreed to but for a binder substituting for a full contract.

Specific language in a binder that the parties are not to be bound until execution of a formal agreement has been honored by courts. (Why then sign a binder?)

What if the binder is agreed to be "subject to a formal contract"? It depends, and those are words laden with trauma. The courts would have to look at each case to determine whether the intention of the parties was to be immediately bound, with the "formal contract" to just be a more artistic version of their understanding, or if the intention was not to be bound at all until execution of the more formal writing. Obviously with court and counsel wrestling with the effect of such qualifying language, a layman certainly cannot be expected to know what he is getting into.

Of course, the confusing question of qualifying language need not be reached until it is determined that the essential elements of a contract have been met. These elements are usually said to be:

(1) The parties (rarely a problem);
(2) Mutual promises (rarely a problem);
(3) Subject matter, including an identification description;
(4) Price and Consideration.

Description

The property must be described with reasonable certainty, which is obvious, but more illusory than it might first appear. Clearly, if a legal description is given, there can be no dispute. Beyond a legal descrip-

tion, however, there is considerably less certainty.

The general rule as to sufficiency of description is that it must identify the property or supply the "key" to identification, and parol evidence will be admissible to identify the property where there is such a basis in the description, although no parol evidence will be permitted to add to or vary the description. But even the general rule is of minimal comfort in a given fact situation. The annotation covering this point runs to one hundred pages! (23 A.L.R.2d 6)

Some of the difficulties with the description in the binder are illustrated by the following examples:

—A description of the "Joe Jones House" may be clarified by parol evidence but not if Jones owns more than one house, in which event the description would be insufficient.

—Where a binder attempted to incorporate by reference a description in two title policies, even though incorrectly referred to as two "deeds" it was upheld by a court.

—Where the property is part of a seller's larger parcel, a recital of dimensions or area without delineating the boundary between the subject of the sale and the property to be retained will cause the binder to fall. (This stringency, perhaps surprisingly, would not apply to deeds, as opposed to binders).

—A description of the property by street and number, such as "32 Main Street" *may* be sufficient, but not always. (In Washington State there *must* be a legal description). For example, the highest court in the State of New York ruled upon the adequacy of a street number description and found it adequate. However, in a later case, the description in the agreement was:

> "Property known as and by the street number 1441 Bedford Avenue, being an 8 family brick and stone apartment building on a lot about 33 × 95 irregular."

In actuality, the dimensions were 33 feet, 1–1/4 inches fronting on Bedford Avenue, 93 feet 10 inches deep on the northerly side, tapering to a width of 14 feet 1–1/2 inches in the rear. The Court's ruling was that the actual description was not in compliance with the contract and the buyer was not required to complete the purchase.

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—As a corollary to the prior example, a street number description may be inadequate where the seller owns some additional property used in connection with the house, but not necessarily acquired at the same time, or not otherwise essential to the house.

Terms of Payment

Most binders held unenforceable have failed because of inadequacy in setting forth the terms of payment. As will be seen from the examples to be listed, this is a particularly vexacious problem. If the binder is fatally defective, everyone has wasted time and probably the expense of litigation. If the binder does survive, someone was probably stuck with payment provisions he never expected.

Here are some areas of difficulty in expressing consideration for the transaction:

—In a leading New York case, the language in the binder was:

> "The price is $32,625, payable $12,625 cash; balance of $20,000 to remain on 1st mortgage for 5 years. The sum to be

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paid on signing of contract . . . to be agreed upon. The balance of cash payment on passing of title (giving date)''

The Court ruled that in this instance the amount to be paid on contract was an *essential* element which had not been agreed upon. Hence, no contract was said to exist.

—Language such as a price of $30,000 ''subject to a mortgage of $14,000'' would probably be upheld in Connecticut where the $14,000 would be interpreted as a credit to the buyer. Georgia, on the other hand, would find the language too indefinite and would deny specific performance.

—A binder provision compelling seller to pay taxes and assessments which would become liens upon title closing, except current taxes, would be too ambiguous as to its effect on an assessment payable in installments over a period of years.

—Terms calling for purchaser to ''assume'' existing assessments is too vague to determine if purchaser could deduct their amount from the purchase price.

—Mention of a monetary consideration payable ''as per terms agreed'' violates the Statute of Frauds. There might very well be an oral agreement as to the amount, but it is unincorporated in the writing.

—Where payment of the purchase price is to be deferred to a future time, but the due date is not specified, the binder will be unenforceable. (Perhaps incongruously, where a balance was made payable ''on terms to be agreed'', the binder was valid if the purchaser tendered cash).

—A clause providing for payment of 30% in cash while deferring the balance ''to be agreed upon'' with interest not exceeding 6% would be unenforceable as insufficient explanation of terms of payment.

—Where a purchase money mortgage is to be taken back but no rate of interest or maturity date is specified the majority rule is that the agreement is too vague to be enforceable. The minority view, followed in New York and New Jersey, will imply interest at the legal rate with payment due on demand. The minority presumption, however, will not prevail if some other part of the proposed agreement indicates an intention not to create a demand obligation.

Conclusion

While the foregoing problems are the most common, they do not by any means complete the list of litigated language in binders. Where the time for closing has been left out, it's been fought over in court—the result that the court would fix a reasonable time.

When the place of closing has been omitted the courts have ruled it to be at the seller's residence.

But, where the parties have contracted to close title at a time to be mutually agreed upon, an essential element is missing, rendering the agreement unenforceable.

Neglecting provisions for the apportionment of taxes, insurance, rents and mortage interest will not void the binder because the law will supply provisions, albeit terms the parties would not have preferred.

And even this ancillary list can go on and on—which is precisely one of the main objections to binders. From state to state, and even within a particular jurisdiction, it may be extremely difficult, if not impossible, for an attorney to tell his client whether that binder actually ''binds''. And if it *does* bind, it most certainly will contain less than all the provisions counsel would insist upon for the protection of his client. We then harken back to the authorities who advise against signing binders.

As we've seen, attempts to qualify binders with language such as ''subject to a more formal contract'' may or may not be effective. A provision such as ''subject to the approval of counsel'' or, preferably, ''This binder not to be effective unless and until specifically approved by seller's (or

buyer's) attorney'' would probably negate the binder's effect until that approval was obtained. Again, however, if a qualification is successful, and it usually will be uncertain, what then was the point of the binder? The final answer is none, except to make the client happy.

Probably the most practical service an attorney can render a client desireous of signing a binder is to make himself available for a formal contract. If a seller or buyer wants to be bound, let him be bound by an agreement that contains requisite detail and safeguards. Let him have that to which he is entitled. The public is not properly served by the execution of questionable and incomplete documents.