

Seller's Remorse - The Fixed Price Option to Purchase Real Estate

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It is fairly common for lessors and lessees of real property to include in long-term lease agreements an option to purchase the property. Often, such options to purchase establish a fixed price. Establishing a fixed price option gives rise to substantial risk of which owners/lessors in particular should be wary. Whether you are a commercial or residential owner/lessor, you should think twice before fixing a price for the future sale of your property.

Despite periodic short-term recessions, over an extended time frame, real estate values usually appreciate. Consequently, fixing a purchase price for real property that provides good or even great value today could leave you with only a fraction of the future market value when the option to purchase is exercised. As a lessor and property owner, before agreeing to a fixed price option to purchase in your lease agreement, you should be aware of the following:

- Market fluctuations could significantly affect the value of the option.
- The option will likely be enforceable despite such fluctuations.

If an exercised option price fails to provide you with acceptable returns in relation to market value, your first instinct may be to assert one of the following common defenses against an action for specific performance. For the reasons stated, these defenses are unlikely to provide you with relief.

Common but Unreliable Defenses to an Option Holder's Action to Enforce the Exercise of a Fixed Price Option:

- 1. Unconscionability:** You may try to convince a court that because of the gross disparity between the fixed price and the current market value, the option contract should be declared unconscionable. However, black letter law regarding unconscionability requires both procedural and substantive unconscionability to undo a contract. Therefore, unless you can claim that you were unduly influenced or forced into executing the lease/option agreement, unconscionability will not provide a valid defense to enforcement.
- 2. Rule Against Perpetuities ("RAP"):** If the contract was executed more than 21 years ago, some property owners may try to claim it is invalidated by the RAP. As part of Massachusetts common law, the RAP prevents certain contingent future interests from being valid in perpetuity.

See *J.C. Gray, Rule Against Perpetuities* § 201, at 191 (4th ed. 1942). In Massachusetts, there has been no definitive ruling as to whether the RAP applies to options appurtenant to lease agreements. Therefore, even if the option to purchase is written so as to be valid and exercisable decades beyond the 21-year limitation associated with the RAP, the RAP provides no assurance that the exercise of that option can be avoided or undone. Furthermore, many jurisdictions explicitly forbid the RAP's application to such lease-appurtenant options, lending some support to the option holder's position in an enforcement action.

3. Failure of the Option Holder to Turn the Corners Squarely:

The advantage of option contracts rests with the option holders because they can access future market information before deciding whether to exercise their option to buy. So, the courts require that the option holder adhere strictly to the terms of the option provision. This strict adherence is referred to as "turning the corners squarely." A more familiar expression might be "dot the i's and cross the t's." See, e.g., *Westinghouse Broadcasting, Co. v. New England Patriots Football Club, Inc.*, 10 Mass. App. Ct. 70 (1980). The *Westinghouse* court recognized that this unequal access to information is particularly salient where the intervening period has resulted in "an increase in the value of the optioned rights." *Id.* at 73. Because of this increased burden imposed upon option holders, there are indeed instances in which regretful owners have successfully thwarted claims for specific performance. Such a defense requires the owner to identify where the option holder has failed to exercise the option strictly in accordance with its terms.

Generally, the terms to which the option holder might fail to adhere include those relating to the method and timing of the requisite notice of the intent to exercise the option; the specification of the closing date, time, and place within the notice of intent to exercise the option; whether the option holder is ready, willing, and able to tender performance (e.g., tender the requisite funds) on the date, time, and place specified in the notice of intent to exercise the option; and/or the option holder's failure to satisfy obligations under any other contract provision upon which the option rights have been made contingent.

While the turn-your-corners-squarely rule can provide some measure of relief for the regretful owner, it cannot be relied upon. Significantly, the majority of cases to which it has applied

are those in which the option holder's attempt to cure a failure to strictly adhere to the option terms has occurred after expiration of the option. Thus, the relief provided by the rule arises from the happy accident of the option holder's insufficient attention to detail and poor timing. An owner cannot plan with any degree of comfort to rely upon accidents when negotiating an option to purchase.

CONCLUSION

The best advice for lessors/property owners with respect to lease-appurtenant, fixed price options to purchase is simply to avoid them. The option holder's exclusive access to intervening information, between the execution of the contract and a future decision to exercise the option, means that the option holder alone will benefit from market fluctuation. If the option increases in value, then the option holder is more likely to exercise it; if it decreases, the option holder is less likely to exercise it. The owner, on the other hand, is subject to the whim of the market and the advantage of the option holder. While the larger context of the lease agreement may justify this risk to the owner, owners should nonetheless be aware of the risks associated with fixed price options and the rules relating to their enforceability.

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