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## **Cases Affecting Your Real Property Sales**

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In the last year, two important cases were decided that affect the rights of buyers and sellers of real property. One case has implications in Section 1031 exchanges, while the other seems to invalidate “free look” periods in purchase agreements.

*Section 1031 exchange proceeds may be grabbed by the intermediary’s creditors.* In a Section 1031 exchange, a seller of commercial real estate can defer recognition of capital gain by reinvesting the sale proceeds in other real estate up to 180 days after his sale closes. The seller assigns his sale agreement to an intermediary right before closing, the intermediary collects and holds the sale proceeds, and then it buys the replacement property selected by the seller.

In the case of *In re Landamerica Financial Group, Inc.*, the intermediary filed for bankruptcy. The bankruptcy court ruled that the sale proceeds it held were in the bankruptcy estate and the seller of the property that generated the proceeds was a general creditor.

The proceeds were held in the intermediary’s accounts, making it the presumed owner. To prevail, the seller had to show the proceeds were held in trust. However, the agreement between the seller and the intermediary didn’t use the word “trust,” and other terms of the agreement made clear that the intermediary had no fiduciary duties to the seller, which are the hallmark of a trust relationship. It didn’t matter that the proceeds were held in a segregated account under the seller’s tax ID number. Most “qualified intermediaries” handling 1031 exchanges hold sale proceeds the same way.

*Many purchase agreements may be unenforceable.* Most purchase agreements provide for a “free look” period, during which the buyer can inspect the property, review title, etc., and get his deposit back if he decides to cancel escrow. In *Steiner v. Thexton*, an appeals court ruled that such a contract is not binding on the seller until the deposit becomes nonrefundable, because there is no “consideration”—the buyer hasn’t paid and the seller hasn’t received anything of value yet.

The state Supreme Court recently reversed the appeals court decision based on unusual facts in the case, but stated that for a purchase agreement to be enforceable, the buyer must part with some money or perform some act that the seller bargained for, which either benefits the seller or represents a detriment to the buyer. The court left open whether a refundable deposit can bind the seller.

The California Association of Realtors recently changed their form purchase agreement to provide that the buyer can cancel only in good faith, e.g. if he finds a title or construction defect. It’s doubtful this works, but if it does, it exposes a canceling buyer to a suit by the seller. The best approach is to have a small part of the deposit be nonrefundable; then the seller is bound and the buyer’s right to cancel is protected.

If you are getting ready to enter into a real estate agreement, please contact KDG’s real estate department for counsel.