

NORTHEAST REAL ESTATE BUSINESS™

REAL ESTATE CONTRACTS: LAND USE CLAUSES

Does futility in obtaining development approvals allow buyers to invoke approvals contingency clause and terminate the contract?

Shepard A. Federgreen, Howard D. Geneslaw and Jason R. Tuvel



Federgreen



Geneslaw



Tuvel

One of the primary keys to a developer's success is targeting a site that will allow the developer to achieve his ultimate vision while maximizing his economic return. Determining which sites are most desirable can be an arduous task, and mandating a developer perform the requisite due diligence on the local, county and state levels to ensure the envisioned project may be constructed is of great importance. To protect against the myriad of problematic factors, which can be identified only by a thorough due diligence investigation, developers often include inspection and land use approvals contingency clauses in contracts of purchase entered into with landowners.

Inspection and land use approvals contingency clauses serve the purpose of allowing a developer the ability to terminate the contract if, after proceeding in good faith to inspect the site and prosecute development approvals, the developer concludes that the site cannot be developed as desired. A typical inspection contingency clause gives a prospective purchaser a reasonable time period, typically at least 60 days, to conduct due diligence with respect to such matters as environmental, geotechnical, soil, geological and topographical conditions; zoning requirements and restrictions; engineering issues; and title review and surveys. Typically, at the conclusion of the due diligence period, the developer is free to determine whether to proceed to closing or terminate the contract.

A land use approvals contingency clause is similar to an inspection contingency clause in that it provides the buyer with the ability to terminate his rights under the contract if the buyer is unable to secure necessary land use approvals after prosecuting applications for them in good faith. However, land use approvals contingency clauses

typically provide for a much longer time frame for termination, often measured in months, or even years.

In a recent New Jersey state trial court decision, *Wachovia Bank v. The Gadbeey Organisation*, the interplay of inspection and land use approvals contingency clauses was scrutinized at length. The lesson to be learned from the Wachovia Bank decision is that the parties must draft their contract to define specifically what each contingency clause encompasses.

The Wachovia Bank case centered around a new program undertaken by Wachovia to build 200 new banks in markets in which Wachovia had no presence. The program called for the construction of banking facilities, the smallest of which was to be 4,000 square feet. In June 2003, Wachovia executed a contract to purchase a site in Hillsborough Township, New Jersey, where a 4,000 square foot Wachovia Bank was proposed.

In July 2003, Wachovia filed a site plan application with the Hillsborough Township Planning Board (planning board). Due to the fact that the site was located adjacent to a state road, Wachovia was aware that it would not only need site plan approval from the planning board, but that it would also require an access permit from the New Jersey Department of Transportation (DOT) allowing vehicles to access the site from a state highway.

In October 2003, Wachovia decided to amend its application to the planning board by proposing a different, more cost-effective design. In November 2003, an amendment to Wachovia's contract with the seller of the site was executed to extend the closing date. As a result of this change to the application, the ability to obtain an access permit from the DOT became more complicated than originally anticipated by Wachovia because the

NORTHEAST REAL ESTATE BUSINESS™

amended application did not meet the requirements of the DOT access code regulations. According to Wachovia's traffic engineer, the DOT access permit could not be obtained unless the site plan application was once again amended and reduced the proposed Wachovia Bank to approximately 2,500 square feet. Before deciding to amend its application, Wachovia had several discussions with the Hillsborough Township municipal planner who indicated that in addition to the DOT access permit issue, Wachovia had many other problems, including the failure of the design to conform with recent amendments to the Hillsborough Township master plan. In view of earlier, more neutral comments from the Township planner, Wachovia's representatives took his comments, which they believed to represent the opinion of the planning board, to mean that the application stood virtually no chance of success without substantial further amendment to the site layout and design.

As a result of the concerns raised by the Township planner and the inability to comply with the requirements of the DOT for an access permit, Wachovia believed that proceeding with the planning board application and DOT access permit process would be futile. Thus, in February 2004, Wachovia terminated the contract and sought the return of a substantial deposit. However, the seller refused to return the deposit, asserting Wachovia was in breach of the contract of sale on the grounds that Wachovia did not prosecute its land use applications in good faith to a final non-appealable decision, and that the inspection contingency clause had already been waived. In turn, Wachovia filed a lawsuit against the seller for the return of the deposit.

The Court's analysis in determining whether Wachovia was in breach of the contract of sale and accordingly not entitled to the return of the deposit, turned on several issues concerning the drafting and construction of real estate contracts.

The first issue presented by the court was whether Wachovia was required to

determine the likelihood of success in obtaining a DOT access permit under the Inspection Contingency clause of the contract of sale. This clause provided Wachovia with a 60-day due diligence period to investigate many aspects of the property and proposed development thereon. The Inspection Contingency clause provided that "if, during the Inspection Period, Buyer determines that the Property is not suitable for Buyer's intended development and use of the Property, then Buyer may terminate the Sales Agreement by written notice to Seller and receive full refund of the Deposit."

In order to determine if obtaining the DOT access permit was contingent on the Inspection Contingency clause, the court had to read the aforementioned clause in conjunction with the contract of sale's Land Use Approvals clause. If at the end of the 60-day due diligence period Wachovia had not terminated the contract of sale, then such provision would have been deemed waived. In such an event, Wachovia would only be able to terminate under the Land Use Approvals clause (but not under the Inspection Contingency clause). The court held the DOT access permit was a matter within the purview of the Inspection Contingency clause because such clause was "a broadly permissive bargained for provision permitting Wachovia an opportunity to perform its due diligence investigation into whatever matter(s) it deemed appropriate in its sole discretion." On the other hand, the court held the Land Use Approvals clause to be "limited by its terms to the specific board approval set forth therein. That land use approval contingency was to be satisfied after the board approved the application and when that approval became non-appealable. Wachovia was then required to close title, even though it may not have had the DOT access permit that Wachovia claims to also be the subject of the land use contingency."

The reasoning behind the court's decision on this initial issue was that even

though the DOT access permit can be construed as a land use approval, and perhaps planning board approval, would have been made contingent on obtaining the DOT access permit, the Land Use Approvals clause failed to make any mention of obtaining permits from DOT and was, in fact, solely limited to planning board approval.

The primary evidence behind the court's rejection of Wachovia's argument that obtaining the DOT access permit fell under the Land Use Approvals clause came during a fact finding investigation by the Court of prior drafts of the contract of sale which included language within the Land Use Approvals clause that covered all approvals which "were necessary to construct a new banking facility." In fact, the court noted that at the deposition of the Wachovia attorney, who drafted the agreement, the attorney admitted that the Land Use Approvals clause was modified from its prior all-inclusive language.

In addition, the court stated that although one of the arguments asserted by Wachovia was somewhat persuasive, ultimately the language of the contract of sale contradicted Wachovia's position. Wachovia argued that the following language conveyed that the intent of the parties was to include the DOT access permit in the Land Use Approvals Clause:

During the Land Use Approval Contingency Period the Buyer, as the applicant shall file an application with the Hillsborough Township Planning Board seeking approval to construct a new banking facility pursuant to its plans, with satisfactory access and signage.

Although, this language regarding "access" was within the Land Use Approvals clause, the language which immediately followed convinced the court that the intent of the parties was to restrict said provision to planning board approval. The following language reads as follows:

The Buyer and Seller understand that banks are a permitted use in the district

CONNECTING REAL ESTATE IN THE NORTHEAST

NORTHEAST REAL ESTATE BUSINESS™

and that site plan and zoning approval are required, and that approvals will also be required for side rear set backs and impervious surface coverage and for lot size. Buyer shall promptly prepare and submit its application and diligently prosecute them.

The above language references approvals and/or variances, which Wachovia may have been required to obtain in order to receive approval for the construction of a bank. However, all of the aforementioned approvals are derived solely from the planning board and not from any other governmental body or agency. Hence, the court construed the Land Use Approvals clause to be limited to all approvals required from the planning board. In rendering this conclusion, the court emphasized, “[a] court has no power to rewrite the contract of the parties by substituting a new or different provision from what is clearly expressed in the instrument.”

The next issue examined by the court was whether the impossibility of obtaining a DOT access permit would excuse Wachovia from performing its obligations under the contract of sale. New Jersey case law does hold that “when a party to a contract is unavoidably prevented, through no fault of its own, from discharging a contract, the obligation of that party to fulfill the contract is excused.” In *Wachovia Bank*, the court found that it was not impossible for Wachovia to obtain a DOT access permit or to obtain approval from the planning board. The court believed that the facts demonstrated that Wachovia chose to abandon its land use application before the planning board and process for obtaining a DOT access permit because it perceived that it could not obtain such approvals.

The discussions that Wachovia had with the Township planner regarding many problems with the planning board application, and the fact that Wachovia’s own traffic engineer believed obtaining a DOT access permit would be next to impossible, did not persuade the court to excuse Wachovia from performance. The court found this evidence to be nothing more than speculation on the part of Wachovia as to the merits of obtaining planning board approval and a DOT access permit.

The court concluded that Wachovia was in breach of the contract of sale and thus had forfeited its deposit. This decision, which, as a trial court decision, is not precedential, nevertheless provides guidance for both developers and attorneys whose focus involves the structuring of contracts for the purchase of real estate in which obtaining land use approvals are a prominent aspect of the transaction. The attorney or any other individual designated to draft or review a contract on behalf of a developer must pay close attention to the language within and differences between Inspection Contingency and Land Use Approvals clauses. Limiting a Land Use Approvals clause to an approval of one board could result in the outcome suffered by Wachovia. Attorneys should draft such provisions to be all-inclusive, thereby covering all necessary land use approvals needed. Thus, if multiple boards or governmental agencies come into play, the Land Use Approvals clause will cover such approvals and enable a developer to terminate a contract if certain permits or approvals are unable to be obtained. In addition, if a contract has already been drafted and an approval and/or permit is necessary that was unforeseeable at

the outset of the transaction, the attorney representing the developer may want to execute an amendment to the contract to ensure such approval and/or permit is covered by the contract’s Land Use Approvals clause.

Furthermore, in order to avoid the need to invoke the doctrine of impossibility or similar contractual doctrines excusing performance by a party, drafters of contracts for the sale of real estate should consider inserting explicit language in a contract allowing the purchaser to terminate the contract based on necessary land use applications or processes to obtain permits being futile in the sole opinion of the purchaser (or as close to that standard as can be negotiated). This would allow a purchaser to terminate as it sees fit, although such determination would be strengthened if supported by the opinions of consultants and municipal advisors in making a determination of futility. Inserting this language should:

- Act as a deterrent to a seller accusing a purchaser of breach of contract for failure to proceed with such applications even though the seller concludes there is no likelihood of success,
- And protect the purchaser in court should the seller refuse to return a deposit. If coupled with the recovery of attorneys’ fees provisions, the purchaser will be in about as good a position as we believe possible.

Shepard A. Federgreen and
Howard D. Geneslaw are directors
and Jason R. Tuvel is an associate
at Gibbons P.C.
