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California Court Applies Implied Covenant of Good Faith and Fair Dealing to Extend Close of Escrow

On March 16, 2009 the Second Appellate District of the California Court of Appeal in *Peak-Las Posita Partners v. Michael Bollag* (2009) affirmed a trial court decision that ordered the extension of escrow when the seller was found to have acted unreasonably in refusing to extend escrow to complete a lot line adjustment. The courts ruled that the seller was “bound by an implied covenant of good faith and fair dealing not to do anything that would destroy or injure [the buyer’s] rights under the purchase agreement.”

In 1999, Michael Bollag entered into a land sale contract to sell Peak-Las Positas Partners (PLP) 4.5 acres for \$475,000 with a \$150,000 non-refundable deposit, and scheduled the close of escrow so that PLP could obtain a lot line adjustment for a residential development. The parties amended the contract in 2001 to extend the close of escrow for five years to allow the annexation of PLP’s property into the City of Santa Barbara and the approval of the lot line adjustment by the City. At that time Bollag received \$315,000 from PLP “as an ‘incentive’ to complete the transaction.” The amendment allowed for future escrow extensions “by mutual consent of Buyer and Seller, which consent shall not be unreasonably withheld or delayed.”

On March 8, 2006, the city council voted against PLP’s project after PLP had spent almost \$5 million in project costs and had paid seller \$465,000 (just \$10,000 less than the purchase price and all of which was credited to the purchase price). After meeting with city officials, PLP agreed to make changes for the lot line adjustment, but needed more time to submit the changes. Consequently, PLP requested a two-year extension to escrow. Bollag denied the request.

On August 7, 2006, PLP sued Bollag for specific performance and declaratory relief. The city council approved the annexation and the lot line adjustment on December 13, 2006 (five months after Bollag denied PLP’s request to extend the closing of escrow). The trial court found that Bollag acted unreasonably by not granting the extension and breached the contract and ordered the extension of “escrow until July 23, 2008, or 60 days after the judgment became final.”

The trial court found and the appellate court confirmed that “the purchase agreement must be interpreted to carry out the mutual intentions of the parties (Civ. Code § 1636) and that Bollag was bound by an implied covenant of good faith and fair dealing not to do anything that would destroy or injure PLP’s rights under the purchase agreement.” Bollag argued that denial of the extension was reasonable because of, among other things:

- Landslide liability;
- Need for landslide liability insurance;
- Buyer did not act diligently in processing the project;
- Alleged cloud on title;
- Security and privacy issues; and
- Buyer’s alleged breach of the purchase agreement.

The trial court ruled that each of seller’s justifications were not reasonable and did not warrant denying the buyer’s request for the extension. Had the court ruled that seller’s actions were reasonable, the buyer stood to lose the \$465,000 previously paid to seller, in addition to the \$5 million dollars buyer had spent in processing the project.

In light of this decision, parties to a real estate purchase agreement had better be certain that their decisions are reasonable when they decide not to extend escrow or withhold consent to carry out the mutual intentions of the parties.

Also, parties to a real estate sales agreement should realize the true impact that adding an innocuous phrase like: “by mutual consent of Buyer and Seller, which consent shall not be unreasonably withheld or delayed” has on the parties and the transaction. In this case, when it was included in an amendment to extend escrow by five years, it cost the seller \$511,282.50 in attorneys’ fees (\$36,282.50 more than the

purchase price) when the seller refused to extend escrow an additional two years. Just think of the impact the phrase could have on other provisions of a real estate sales contract.

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