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OPTIONS, ORPHANS OF THE LAW

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INTRODUCTION

HISTORICALLY, the real estate option agreement has been an orphan passed back and forth by the established households of contract and real property law. Most present day real estate sales are based, in the first instance, on option arrangements. Many of the sales involve great sums of money. Despite the frequency and economic scope of such transactions, however, option agreements and the rights of the parties involved therein are somewhat nebulous. The option contract is, in the eyes of many, a "noncontract," and the enforceable rights and duties it may or may not create often seem fragile in the face of legal attack. Consider these comments about option agreements which appear in *Thompson on Real Property*:

> One who has a *legal right but not a duty* to buy land or other property holds an option. . . . It is merely *an agreement to hold an offer to sell property open for a specified time.* A "binding option" for the purchase of land *is a contract, but it is also an offer,* which, when accepted, *will create another contract.* . . .
>
> An option *is not an actual or existing contract, but merely a right reserved in subsisting agreement.* It is a continuing *offer of a contract* . . . . *The option is not a sale. It is not even an agreement for a sale.* At best, *it is but a right* of election in the party securing the same to exercise a privilege, and only when that *privilege* has been exercised by acceptance *does it become a contract to sell.*[1]

Such statements are common and correct summaries of the law applicable to option arrangements. They are, in most instances, reflective of general law on the subject and, more specifically, of Colorado law.

In Colorado, decisions dealing with option arrangements have flowed from the appellate level since 1880, and at this point in time there are at least 50 cases within the Colorado reports. Despite this sizeable body of law dealing with options, those arrangements are often created and entered into with comparatively little concern or legal forethought. It is the primary purpose of this article to accumulate the Colorado cases

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[1] 8A. G. THOMPSON, THOMPSON ON REAL PROPERTY § 4443 (repl. 1963) (emphasis added).

dealing with options and to highlight their impact as an aid to the creation, exercise, and enforcement of these nebulous agreements.

I. CREATING THE OPTION

Because courts look upon options as unilateral contracts, binding only the optionor until exercise of the option, they are strictly construed against the optionee.[2] Moreover, the impact of the option's terms is generally viewed as a question of law which an appellate court may resolve without being bound by findings and conclusions made at the trial level.[3]

These strictures, as well as common sense, demand that the agreement should be clear and definitive in its terms.[4] Certainly parties, consideration,[5] property descriptions,[6] term,[7] and especially the manner in which the option may be exercised[8] should be definitively set forth. The option must, of course, be in writing to satisfy the statute of frauds, unless one prefers to live his life the dangerous way and hopes to satisfy the statute through proof of part performance.[9]

Payment of adequate consideration for the option is of particular significance.[10] Without the receipt of a good and valuable consideration for his grant of an option, the optionor has made only an offer to which there is no existing mutual obligation on the part of the optionee.[11] This offer, therefore, can be withdrawn by the optionor at any time before acceptance. The optionee's acceptance, however, is rigidly required to be in strict accordance with the terms of the agreement.[12] Recital of consideration is not, by itself, enough to make the

[2] Miller v. Carmody, 152 Colo. 353, 384 P.2d 77 (1963); Rude v. Levy, 43 Colo. 482, 96 P. 560 (1908); T.W. Anderson Mortgage Co. v. Robert Land Co., 480 P.2d 109 (Colo. App. 1970 — not selected for official publication).

[3] Boulder Co. v. Poor, 497 P.2d 1281 (Colo. App. 1972 — not selected for official publication). *See also* Meier v. Denver U.S. Nat'l Bank, 164 Colo. 25, 431 P.2d 1019 (1967).

[4] Mestas v. Martini, 113 Colo. 108, 155 P.2d 161 (1944).

[5] Gordon v. Darnell, 5 Colo. 302 (1880).

[6] Hill v. Chambers, 136 Colo. 129, 314 P.2d 707 (1957).

[7] Gould v. Rite-Way Oil & Inv. Co., 143 Colo. 65, 351 P.2d 849 (1960).

[8] Shull v. Sexton, 154 Colo. 311, 321, 390 P.2d 313, 318 (1964). This case is interesting in that the omission as to the manner of exercise in the agreement was cured by the optionee tendering the full purchase price.

[9] COLO. REV. STAT. ANN. § 59-1-8 to -9; Hill v. Chambers, 136 Colo. 129, 133, 314 P.2d 707, 709 (1957); Mestas v. Martini, 113 Colo. 108, 155 P.2d 161 (1944); Boyd v. McElroy, 105 Colo. 527, 100 P.2d 624 (1940).

[10] Stanton v. Union Oil Co., 111 Colo. 414, 420, 142 P.2d 285, 288 (1943); Gordon v. Darnell, 5 Colo. 302 (1880).

[11] Gray v. Quiller, 144 Colo. 54, 355 P.2d 99 (1960).

[12] Rude v. Levy, 43 Colo. 482, 96 P. 560 (1908), and Gordon v. Darnell, 5 Colo. 302 (1880), are the leading cases on this point in Colorado.

option irrevocable.[13]

The sanctity conferred by the payment of adequate consideration can be lost if the optionee has the right to compel repayment of his consideration in the event he does not exercise the option.[14] However, the enforceability of the option is not destroyed if, upon exercise of the option, the consideration for the option is to become a credit against the purchase price.[15]

An *unconditional* obligation to pay an option consideration in installments may also satisfy the consideration requirement, but this is treading dangerous ground.[16]

Whatever infirmities may exist as to the initial adequacy of consideration, Colorado courts (unlike some) have consistently held that once the optionee unequivocally accepts the offer of sale and obligates himself to purchase the optioned property, the initial failure of consideration is no longer significant. The optionor cannot thereafter refuse to perform because of the original lack of mutuality in the contract.[17]

Creating the option arrangement also requires care to avoid constructing either a firm purchase and sale contract or a security arrangement. If the enforceability of the agreement hinges upon the occurrence of an external condition rather than upon the optionee's election, a conditional but otherwise mutually enforceable agreement — not an option — is created.[18]

Where options are constructed so that the optionee enters into possession and use of the property, usually under a lease arrangement, and thereafter pays substantial amounts of money in order to retain his interest in the property, the Colorado Supreme Court has tended to view the agreement as a purchase and sale contract. Since the doctrine of equitable conversion applies in Colorado, finding such a contract means also finding a security arrangement.[19] The seller who continues to hold

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[13] Rude v. Levy, 43 Colo. 482, 96 P. 560 (1908).

[14] *See* Gould v. Rite-Way Oil & Inv. Co., 143 Colo. 65, 351 P.2d 849 (1960); Stiles v. McClellan, 6 Colo. 89 (1881).

[15] Miller v. Carmody, 152 Colo. 353, 384 P.2d 77 (1963).

[16] Helmericks v. Hotter, 30 Colo. App. 242, 492 P.2d 85 (1971).

[17] Frue v. Houghton, 6 Colo. 318 (1882), and Gordon v. Darnell, 5 Colo. 302 (1880), are the early cases on this point. Stanton v. Union Oil Co., 111 Colo. 414, 142 P.2d 285 (1943), is a more recent case containing a discussion as to when mutuality of obligation arises.

[18] Tallman v. Smith, 112 Colo. 217, 148 P.2d 581 (1944). *See also* Gould v. Rite-Way Oil & Inv. Co., 143 Colo. 65, 351 P.2d 849 (1960); Rocky Mountain Gold Mines, Inc. v. Gold, Silver & Tungsten, Inc., 104 Colo. 478, 93 P.2d 973 (1939); Stelson v. Haigler, 63 Colo. 200, 165 P. 265 (1917); *In re* Gauthier, 493 P.2d 377 (Colo. App. 1972 —not selected for official publication).

[19] Konecny v. von Gunten, 151 Colo. 376, 379 P.2d 158 (1963).

legal title is viewed as retaining a security right in the property. The overall effect of such agreements, therefore, is that the "optionor" holds a security interest and must proceed by foreclosure if there is default by the "optionee."[20] The practical result of such a foreclosure requirement is that the optionee need not forfeit all of his "consideration" for the agreement. Similarily, where options to acquire title to property are given for the essential purpose of guaranteeing the payment of money by the "optionee," the Colorado courts view the overall transaction as a security arrangement.[21]

Whether a resultant agreement is or is not an option, as opposed to a contract of purchase and sale, can be of particular interest to the realtors who might be involved in the transaction. Absent an agreement to the contrary, if the agreement is an option, the realtor's commission is unearned and remains unearned if the option is not exercised.[22]

Considering the tendency of some purported option agreements to migrate into the purchase contract or security arrangement families and to make their presence felt within the homes of brokerage or agency agreements, one has to speculate about the true blood bond of the so-called "Receipt and Option Agreement" forms, commonly a part of modern real estate transactions. Although these forms vary considerably in their terms, the one most commonly used is that which carries the written endorsement of the Colorado Real Estate Commission. The current printing of this form is a hasty pudding type of instrument with something in it for the prospective seller, buyer, and realtor.

The agreement is constructed on a basis which normally results in the prospective purchaser delivering a specified sum as "earnest money" to the realtor who holds a "listing" for the sale of given property. The owner of the property then has a

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[20] *Compare* Rocky Mountain Goldmines, Inc. v. Gold, Silver & Tungsten, Inc., 104 Colo. 478, 93 P.2d 973 (1939), *and* Fairview Mining Corp. v. American Mines & Smelting Co., 86 Colo. 77, 278 P. 800 (1929) *with* Smith v. Schreiber, 93 Colo. 497, 27 P.2d 491 (1933), *and* Strauss v. Boatright, 160 Colo. 581, 418 P.2d 878 (1966). In the latter case the fact that rents paid during the optionee's possession were not applied to the purchase price seems most persuasive in establishing the contract to be a true lease and option as opposed to a sale and security arrangement.

[21] Blackstock v. Robertson, 42 Colo. 472, 94 P. 336 (1908); Borcherdt v. Favor, 16 Colo. App. 406, 66 P. 251 (1901).

[22] Stelson v. Haigler, 63 Colo. 200, 165 P. 265 (1917). In Rocky Mountain Gold Mines, Inc. v. Gold, Silver & Tungsten, Inc., 104 Colo. 478, 93 P.2d 973 (1939), the fact that the realtor involved had received compensation was a factor in the court's conclusion that a sale contract, and not an option, had been entered into by the parties.

given period of time to accept the contract. This creates an "option" in the owner-seller for such period of time for which he, the possible seller, has given no consideration.[23] If accepted by the seller, the contract provides that time is of the essence, and that, if the buyer fails to perform any condition as required, the contract will be null and void and the seller will retain the earnest money deposit as liquidated damages. The document contains a firm obligation to buy on the part of the purchaser if the seller exercises his "option," but there is a spectacular omission of any firm covenant on the part of the seller to sell, albeit there are covenants that he will execute a deed and deliver possession.

From the face of these form documents, it would appear that termination of the contract is the only remedy for default for either the buyer or the seller. Such being the case, the agreements would appear to create a hybrid type of option even after execution by the seller, or, in effect, an option springing from an option. That is, the parties still have alternative rights either to consummate the contemplated purchase and sale, or to forfeit or return the earnest money, as the case may be, and be free of any further obligation. Clearly, it is arguable that the buyer retains the choice of defaulting and forfeiting his deposit, thereby nullifying the contract instead of performing.

However courts may have previously assessed such agreements, the door now seems to be closed fairly tightly against a party's avoiding his obligation to convey (and possibly to buy) once the other party has fully met or tendered his obligations. The case of *Coppom v. Humphreys*[24] embraced a situation where the buyers had tendered their contractual obligations to a recalcitrant seller. With considerable force, the Colorado Supreme Court, speaking through Mr. Justice Groves, compelled the seller to specifically perform in equity, thus planting a sense of duty where none grew before.

> There are persons who have so far outgrown their catechism as to believe that their only duty is to themselves.
>
> Samuel Johnson

II. Exercising the Option

Of those Colorado cases which deal with option arrangements, the majority involve determining whether the conditions of a given option have been properly satisfied or exercised, thereby converting the option arrangement into a contract of

[23] *See* text p. 284 *supra.*

[24] 171 Colo. 410, 467 P.2d 816 (1970).

purchase and sale which may be specifically enforced.

The basic rule in Colorado as elsewhere is that an optionee must strictly meet the conditions of his option in order to validly exercise the option and to maintain an action compelling the optionor to perform.[25] Consequently, if the option agreement requires written notification of exercise, verbal notice has been held legally insufficient.[26] Failure to render payment or to timely meet any other condition is also fatal to the optionee's rights.[27] If the agreement is silent as to when and where an act must be performed, Colorado courts have sometimes implied a reasonable time and place for performance.[28] However, to omit a time certain for the exercise, or a definite term for the existence of an option, may be to expose the agreement to an assault under the rule against perpetuities.[29] If an option agreement requires that payment of part or all of the purchase price be made concurrent with the act of exercise, notice alone of an intent to exercise, without payment, will not satisfy the agreement.[30] Neither will the existence of a dispute as to the amount which should be paid relieve the optionee from the duty to tender payment.[31]

Conditions precedent to exercise and conditions concurrent with exercise may be expressly or impliedly waived by the optionor; and, if clearly waived, the optionee will be granted specific performance against the optionor.[32] Some of the Colorado cases show a surprising tendency to hold that acts on the part of the optionor constitute a waiver or extension as to the time limit placed upon the optionee's right of exercise, even in the absence of new consideration by the optionee for what is, in effect, an extension of his option period.[33] These cases, however, largely represent situations where the conduct of the

[25] Rude v. Levy, 43 Colo. 482, 96 P. 560 (1908), and Gordon v. Darnell, 5 Colo. 302 (1880), are the leading cases on this point in Colorado.

[26] T.W. Anderson Mortgage Co. v. Robert Land Co., 480 P.2d 109 (Colo. App. 1970 — not selected for official publication).

[27] Strauss v. Boatright, 160 Colo. 581, 418 P.2d 878 (1966).

[28] Shull v. Sexton, 154 Colo. 311, 390 P.2d 313 (1964); Tallman v. Smith, 112 Colo. 217, 148 P.2d 581 (1944); Boyd v. McElroy, 105 Colo. 527, 100 P.2d 624 (1940); Beckman v. Taylor, 80 Colo. 68, 49 P.2d 262 (1926).

[29] Gould v. Rite-Way Oil & Inv. Co., 143 Colo. 65, 351 P.2d 849 (1960).

[30] Miller v. Carmody, 152 Colo. 353, 384 P.2d 77 (1963); Howard v. Interstate Dev. Co., 29 Colo. App. 287, 483 P.2d 1366 (1971).

[31] Miller v. Carmody, 152 Colo. 353, 384 P.2d 77 (1963).

[32] Williams v. Gulick, 170 Colo. 347, 461 P.2d 211 (1969); Dreier v. Sherwood, 77 Colo. 539, 238 P. 38 (1925). *See* Coppom v. Humphreys, 171 Colo. 410, 467 P.2d 816 (1970) (but, query, is an option really present in this case?).

[33] Phares v. Don Carlos, 71 Colo. 508, 208 P. 458 (1922); Wishered v. Noonen, 71 Colo. 218, 205 P. 530 (1922); Poertner v. Razor, 500 P.2d 989 (Colo. App. 1972 — not selected for official publication).

optionor was such as to estop him from demanding strict adherence to the original time limit. The normal rule is that the option period cannot be extended without additional valid consideration, and that an extension without such consideration creates merely a revocable offer.[34] Because of this rule, the sound practice would be for an optionee to always pay a significant sum for an extension of his option period, despite the equitable relief of a gratuitous extension which sometimes appears in the Colorado cases.

Either by a deliberate act of the optionor or by other causes, valid acts of exercise are often rendered impossible of performance. Frequently, the difficulty stems from the fact that the option agreement itself is simply not clear as to what are the mechanics of exercise. In such ambiguous option situations, the courts have held that the optionee can protect his rights under his agreement and be in a position to demand specific performance if he manifests an unqualified determination to exercise his option.[35] Similarly, if acts of the optionor delay or obstruct the optionee in his attempts to validly exercise the option, the optionee can preserve his rights to specific performance by clearly demonstrating an intent to be bound to purchase the property involved.[36] Should there be clear evidence that a tender or attempt to exercise would be a useless act, *and if that fact is known to the optionee,* tender of exercise may be excused.[37] Nonetheless, prudence would dictate that even in such situations the optionee make a clear demonstration that he has committed himself, without condition, to proceed with the purchase. Unqualified tender — somewhere, somehow — is the best way to demonstrate such determination; it cures, as well, many of the infirmities that may have infected the initial option agreement.[38]

Acts done in part performance of, or in reliance on, the contract of purchase and sale which would flow from an exercise of the option may also serve to constitute an exercise of the option. This allows the optionee to seek specific performance, particularly where such acts were instigated, or

[34] 8A G. THOMPSON, THOMPSON ON REAL PROPERTY § 4444, at 264 (repl. 1963).

[35] Shull v. Sexton, 154 Colo. 311, 390 P.2d 313 (1964); Abrahamson v. Wilson, 131 Colo. 580, 284 P.2d 662 (1955); Howard v. Interstate Dev. Co., 29 Colo. App. 287, 483 P.2d 1366 (1971).

[36] Howard v. Interstate Dev. Co., 29 Colo. App. 287, 483 P.2d 1366 (1971).

[37] Coppom v. Humphreys, 171 Colo. 410, 467 P.2d 816 (1970); Ruark v. Peterson, 30 Colo. App. 162, 491 P.2d 75 (1971).

[38] Shull v. Sexton, 154 Colo. 311, 390 P.2d 313 (1964).

acquiesced in, by the optionor.[39]

> The wise man knows that the very polestar of prudence lies in steering by the wind.
>
> Baltasan Gracian

III. ENFORCING THE OPTION — BREACHES AND REMEDIES

The most common act of breach of the option by the optionee, as indicated, is the failure to perform some act or condition of the option by the time or in the manner required.[40] Where this occurs, the remedy of the optionor is generally to declare the optionee's rights at an end, freeing the optionor of any future duty to convey the property in question pursuant to firm contract rights.[41] This is generally all that is desired by the optionor. If his title is under cloud from the option, the court decree which runs against the optionee to void the option will clear title. In any event, a recorded option will cease to give constructive notice one year following the date specified for conveyance.[42]

Conversely, in the normal case of a defaulting optionor, his default lies in his refusal to acknowledge that the option was validly exercised and that the optionee is entitled to specific performance of the contract of purchase and sale which arises after exercise. In such situations, the remedy for breach generally sought by the optionee is specific performance of that contract.[43] A peculiar situation sometimes arises when the optionee has cause to believe his optionor cannot or will not ultimately perform specifically if he, the optionee, should exercise the option. At least in one such situation, a declaratory judgment was successfully sought to test the air around the option.[44] The caveat here, however, is that the courts have often refused to evaluate a party's ability to perform until and unless the time for such performance arrives.[45] Patience, then, may be the only answer in such situations.

> Adopt the pace of nature; her secret is patience.
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> Ralph Waldo Emerson

CONCLUSION

Despite the clarity with which most Colorado cases speak to each specific question the option agreement presents, the

[39] Coppom v. Humphreys, 171 Colo. 410, 467 P.2d 816 (1970); Shull v. Sexton, 154 Colo. 311, 390 P.2d 313 (1964); Hill v. Chambers, 136 Colo. 129, 314 P.2d 707 (1957); Byers v. Denver Circle R.R., 13 Colo. 552, 22 P. 951 (1889).

[40] *See* text p. 288 *supra.*

[41] Rude v. Levy, 43 Colo. 482, 96 P. 560 (1908).

[42] COLO. REV. STAT. ANN. § 118-6-11 (1963).

[43] Beckman v. Taylor, 80 Colo. 68, 249 P. 262 (1926).

[44] Wysowatcky v. Francis, 483 P.2d 1353 (Colo. App. 1971).

[45] Abrahamson v. Wilson, 131 Colo. 580, 284 P.2d 662 (1955).

decisions do not either fully adopt or fully reject the option as a defined and blooded member of the contract family. That being the situation, one has to wonder why usage of the option arrangement persists and grows. Probably, it is because deal-making circumstances often need the latitude options offer, and because the law in its grace (and it *is* a graceful science) recognizes that need.

When used, the option indicates that the prospective seller half does and half does not wish to sell, and that the prospective buyer is similarly uncertain or undetermined. Otherwise, either or both would insist upon a firm contract of purchase and sale. Obviously, for those who like certainty in their lives, the firm contract route is the preferred path. Prospective sellers and buyers usually fare better when they make their contractual commitments at that point and upon those terms on which their minds have fully met. There may be unhappy moments for all concerned before they bite the bullet and close the sale, but there is a certainty about it that, in the overall, lightens everyone's load.

> It is seldom very hard to do one's duty when one knows what it is, but it is often exceedingly difficult to find this out.
>
> Samuel Butler